CASES DECIDED
IN
THE UNITED STATES COURT OF CLAIMS

MAY 1, 1976 TO JULY 31, 1976

WITH

REPORT OF DECISIONS OF THE SUPREME COURT IN COURT OF CLAIMS CASES

REPORTED BY
AUDREY BERNHARDT
REPORTER

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WILSON COWEN

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ROALD A. HOGENSON

Trial Judges

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[1] Retired, effective January 1, 1971, and recalled as a senior trial judge.

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(Charged with the defense of the Government)

May 1, 1976 to July 31, 1976

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Tax Division

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[For court term 1975–1976]

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JUDGE MARVIN JONES

MEMORIAL TO JUDGE MARVIN JONES

Judge Marvin Jones died on March 4, 1976 at Amarillo, Texas. He was survived by a sister, Mrs. Jeff M. Neely, of Amarillo, and a brother, Herbert K, of Lubbock, Texas. On June 9, 1976, the United States Court of Claims held a Memorial Proceeding for Judge Jones in the main courtroom of the Court of Claims, and sitting were Chief Judge Wilson Cowen, Senior Judge Don N. Laramore, and Associate Judges Oscar H. Davis, Byron Skelton, Philip Nichols, Jr., Shiro Kashiwa and Marion T. Bennett. The following proceedings ensued.

CHIEF JUDGE COWEN: This court is convened in this memorial session in honor of our great and beloved former Chief Judge Marvin Jones, who presided over the court for 17 years from July 1947 to July 1964. We take particular note of the presence here today of several of his relatives. They are his nephew, Mr. Frank P. Jones, Jr., of Bethesda, Maryland, who is accompanied by his wife and his mother, Mrs. Frank P. Jones, Sr., of Lubbock, Texas; also Judge Jones' niece, Mrs. William W. Goodrich, of Arlington, Virginia, who is accompanied by her husband and by two grandnephews of Judge Jones: Mr. William W. Goodrich, Jr. and Mr. Frank Marvin Moss. We acknowledge the presence of many friends of Judge Jones, including Judge Charles Fahy, Senior Circuit Judge of the United State Court of Appeals for the District of Columbia; Judge Evan Howell, a former judge of this court; Judge George L. Hart, Jr., of the United States District Court for the District of Columbia; Honorable Scott P. Crampton, Assistant Attorney General in charge of the Tax Division, Department of Justice, and many others, including members of the bar, attorneys from the Department of Justice and employees of the court.

214-954—77——2

General Thomas H. King, the current Chairman of the Court of Claims Committee of the Bar Association of the District of Columbia, is a veteran practitioner who argued many cases before the court while Judge Jones presided. He greatly respected and deeply admired Judge Jones and is here today to speak for the bar. It is a pleasure at this time to recognize General King.

GENERAL KING: Chief Judge Cowen and members of the court, Mister Justice Clark, Congressman Mahon, other distinguished guests, ladies and gentlemen.

May it please the court:

As Chairman of the Court of Claims Committee of the Bar Association of the District of Columbia, which includes among its members many lawyers who practice regularly before the court, I am privileged to submit the following memorial:

Marvin Jones, a native of the Lone Star State, was one of a small group of Americans who held very high positions in all three branches of our Government. He passed away on March 4, 1976, at his home in Amarillo, Texas, at the age of 94.

He was a native of Cook County, Texas, and graduated from Southwestern University at Georgetown, Texas in 1905. He received his law degree from the University of Texas in 1907. Judge Jones was a bachelor.

He served in the House of Representatives from 1917 to 1940. From 1931 to 1940 he was Chairman of the House Committee on Agriculture. He spearheaded the passage of much farm legislation, including the Agricultural Adjustment Act of 1933, the Farm Mortgage Refinancing Act of 1933, the Farm Credit Administration Act of 1933 and the Soil Conservation Act.

In 1940 he was appointed Associate Judge of the United State Court of Claims by the late President Franklin D. Roosevelt. At the President's request, he took a leave of absence from the court in January 1943 to serve as Assistant to the Director of Economic Stabilization. He was President of the United Nations Conference on Food and Agriculture and Chairman of the United States delegation. In June of 1943 he became Administrator of the War Food Administration and remained in that position until July 1 of 1945, after perform-

ing an outstanding job in assuring an adequate supply of food for our military forces, the civilian population, and many of our allies. At that time he returned to the bench and in July of 1947 he was named the Chief Judge of the Court of Claims by President Truman. He served in this position until his retirement on July 14, 1964, when he became a Senior Judge of the Court of Claims.

Judge Jones' service as a Senior Judge was equally distinguished as his performance as an active judge of the court. He sat not only with the Court of Claims but on several hundred cases with the United States Court of Appeals in different sections of this Country. The Supreme Court appointed him as Special Master in a suit which involved a boundary line dispute between the States of Mississippi and Louisiana. He concluded his assignment with dispatch and his report on the case was unanimously adopted by the Supreme Court as the basis for its decision.

If I may be permitted to add a personal note, I would like to say that Judge Jones was a member of this court when I was first admitted to its bar and I tried my first case in the Court of Claims after he became Chief Judge. In the nearly 30 years that I have practiced before this court, I have never known a judge who combined kindness and firmness with such consummate skill or one who was more keenly aware of the human problems involved in the litigation before him. Of great significance to me as a practitioner was the fact that he guided the court in reaching landmark decisions in military pay cases that will provide important precedents for many years to come.

In a statement of this kind, it is impossible to do more than to outline a few of the salient events in the life of a great man and great judge. However, we can take cognizance of his outstanding contribution to the administration of justice; we can express our gratitude for his devotion to his country; and we can point to his character and integrity as an example which the bench and bar would do well to emulate.

For the reasons stated, the Court of Claims Committee, acting in behalf of the Bar Association of the District of Columbia, respectfully requests that the court's adjournment today be in loving memory of its late Chief Judge, Marvin

Jones, and that a copy of this memorial be published in the official reports of the court.

CHIEF JUDGE COWEN: In 1916, when Marvin Jones was first elected to Congress from Texas, his district embraced a territory that was larger than the State of Ohio. After this huge area was divided into two districts, the first Congressman elected from the new district was a young, lanky, state district attorney named George Mahon. After he came to Congress, he found that he and Marvin Jones had many interests in common. They then became and thereafter remained fast and true friends. The discerning constitutents of Congressman Mahon first elected him to Congress in 1934 to the 74th Congress, and thereafter reelected him to each succeeding Congress. He is the dean of the Texas delegation in the House of Representatives and for many years has been Chairman of the Appropriations Committee of the House. In that capacity he has been the recipient of many awards for his distinguished service. We are honored to have this longtime friend of Judge Jones here today and to recognize him at this time.

CONGRESSMAN MAHON: Distinguished Members of the Court and Friends of the Court; Members of the Marvin Jones Family; Ladies and Gentlemen:

I would like to think of myself as the representative of Congress at the ceremony this morning. Perhaps I am uniquely qualified to speak because I served longer in Congress with Marvin Jones than any present members of the House or Senate. As a result of population growth, his district was cut in half in 1934. This resulted in the creation of the new 19th Congressional District and I was elected in 1934 to represent the new District.

My wife Helen and I were intimate friends of Marvin Jones for 42 years. We have many happy memories of our association together.

Gin rummy was not Marvin Jones' cup of tea. He loved bridge and he played the game with enthusiasm and consummate skill. He was deeply religious. He liked to join with friends around the organ or piano and sing religious hymns. I can almost hear him now as he would join in singing "When They Ring the Golden Bells for You and Me." And the Golden Bells rang for Marvin Jones on March 4th.

What a legacy he left. What a heritage he left to the Jones family! And he loved his family in a very special way.

What a record of achievement Marvin Jones left to the nation! He had the unique honor of serving in high positions in all three branches of the Federal Government: service in Congress for 23 years and for years the Chairman of the House Committee on Agriculture, Advisor and Assistant to the Director of Economic Stablilization, Administrator of the U.S. War Food Administration, Member of the U.S. Court of Claims and Chief Judge of the Court.

Perhaps his finest hours were served in Congress. When he became Chairman of the House Committee on Agriculture, agriculture in America was in a state of collapse. There seemed to be little hope for recovery. He put on the statute books the basic laws in regard to agriculture which have made agriculture the miracle of this century—the most stabilizing economic force in America.

I could mention the Agricultural Adjustment Act, the Soil Conservation Service, the Farm Credit Administration. His contribution to the agriculture of the U.S. is legend.

I can see him now in the well of the House as he brilliantly presented the measures from his Committee. He was the master of debate. I have witnessed no Member of Congress who did a better job.

Marvin Jones was one of the great statesmen of this century. But I like to think of him not as a public official but as a great human being.

Not in my lifetime have I met a cleaner, finer, more decent and more compassionate man than Marvin Jones. He was one of God's noblemen.

In closing let me say—God Bless America again, and in our third century enable the nation to grow more men of the quality and stature of Marvin Jones.

CHIEF JUDGE COWEN: In 1947, when President Harry Truman nominated Marvin Jones to be Chief Judge of the Court of Claims, I went with him to the hearing of the subcommittee of the Senate that met to consider the matter of his confirmation. When I arrived there, the first person I saw was the young and handsome Attorney General of the United States, who appeared for the purpose of urging the Senate to approve the appointment of his friend of many years, Marvin

Jones. The name of that then young Attorney General is Tom Clark. As we all know, he was later appointed to the Supreme Court; served on the high court with great credit to the Court and to himself; was named the first Director of the Federal Judicial Center, and after charting that new organization on a course that was to make it a powerful factor for improving the administration of justice in the Federal courts, he retired, because the law required it, and has since been sitting frequently both as a United States Circuit Judge and as a United States District Judge all over this country. Justice Clark is another close and dear friend of Marvin Jones and we are honored to have him here. At this time we are happy to recognize Mister Justice Tom Clark.

MR. JUSTICE CLARK: It is said that some people are born great, some have greatness thrust upon them and some achieve it on their own. Our friend Chief Judge Marvin Jones comes in the latter category. Believing that great hopes make great men Judge Jones set his eyes on Congress at a very early age. While just a cotton-picking kid (at one dollar a hundred pounds) he was asked by a picker in the next row what he was going to be when he grew up. His immediate answer was "I'm going to Congress." Long before going to the Texas University Law School, he attended political rallies with Sam Rayburn (later The Speaker) in the old Fifth Congressional District of Joseph Weldon Bailey. Both boys emulated Bailey, who had entered Congress at twenty-eight years of age and was Democratic Floor Leader at age thirty-four. He was impressive in stature as well as in person, had an eloquent tongue, and long hair, as black as night, flaring down to his collar. Bailey was aggressive and was always in some kind of controversy. He was no respecter of persons and one day took on Speaker Thomas B. Reed, accusing him of violating his word in not scheduling one of Bailey's pet bills for discussion on the floor. Bailey supporters back in Texas decided to call a mass meeting to support their idol. However, another Resolution was offered at the meeting by an anti-Bailey person in the form of a telegram reading simply: "Dear Joe, cut your hair and come home." The Baileyites were outraged and voted down the telegram but the Rayburn-Jones boys learned their lesson: "politics is no place for the thin-skinned."

In 1916 Marvin Jones realized his boyhood ambition to be a Congressman by being elected to represent the 13th Congressional District of Texas. While in Congress he evidenced the great qualities he strove to develop in his youth and was the author of a number of farm bills that changed the entire course of our agricultural history. We cannot list them all but the more important were the Agricultural Adjustment Act, National Soil Conservation statutes, the Home Owners Loan, the Farm Credit Act and The Sugar Act. You will notice that not one bill was tagged with his own name—a humility seldom known to public figures! In addition, Marvin Jones has more presidential pens, used by President Roosevelt to sign into law the bills sponsored by the recipients, than any other person—a total of thirty-one!

Marvin Jones did receive recognition from the President. He was appointed Judge of the Court of Claims in 1940 but he did not take the bench until 1941 because President Roosevelt insisted that he needed him "in the House." Two years later, FDR again interrupted Jones' judicial service by appointing him War Food Administrator in 1943, an office he filled without resigning from the court. But the great satisfaction of the President is evidenced by his publicly praising Judge Jones as having done "a good job, Marvin!" In 1947 President Truman appointed Judge Jones to the Office of Chief Judge of the Court of Claims. It was my pleasure to have had a part in this appointment, as Attorney General of the United States. Judge Willie Clark—no relation of mine—meanwhile claimed the job of Chief Judge for himself on the theory that he had gone into the Army from the Third Circuit Court of Appeals and was entitled under the G.I. Bill of Rights to the first comparable opening. This was an ingenious claim by the scion of the Clark ONT Thread family (O.N.T. stood for "only new thread") who was also a former United States District Judge. He opposed Judge Jones' confirmation. It was one of two appearances I made before the Judiciary Committee on appointments, during my four years as Attorney General. The committee recommended Judge Jones favorably and he was confirmed.

Chief Judge Marvin Jones wrote hundreds of opinions while sitting on the Court of Claims devoting himself to the attainment of equal justice for all. Some of his words are not

only eloquent but prophetic. For example, when a Korean war prisoner filed a claim against the government for his back pay, Judge Jones wrote:

> "The law has for its purpose the ends of justice; otherwise it is as useless as a child trying to grasp a handful of sunlight * * *. If it fails in attaining justice it fails in everything."

His decisions were short and to the point. An example, is the case where an Austrian woman worked two weeks for the government but was denied payment because of her Austrian citizenship. Chief Judge Jones wrote:

> Plaintiff worked twelve days. The government received the benefit of her services. She has not been paid. Since the Pioneer's axe first rang in the wilderness of America the honoring of honest obligations has been the hallmark of her people.

Judge Jones also called his cases as he saw them—adding color as he went along. A claim against the Army was denied on the grounds that the official was acting in his personal capacity rather than official. In his opinion Judge Jones commented:

> For the Army to contend and provide by regulation that it was not liable because official action was not taken was like a man charged with extra marital activity—rather than denying the charge—defended on the ground that he acted solely in his individual rather than his conjugal capacity.

As Chief Judge of the Court of Claims our friend engaged in many extra-curricular activities. Indeed this stately building in which this courtroom is located was built by him. Almost single handedly he obtained the appropriation for it, worked with the architects on its design and superintended its construction. In fact it is the "Jones Building" and stands as a monument to his devotion, his persuasiveness and the esteem in which he was held. On many occasions, I heard him converse with Speaker Rayburn about "our courthouse." In fact, one day at King and Queen Fishing Club I lost cast after cast to Marvin as he was demonstrating to the Speaker his fishing ability (which was tops) and then in the evening a lot of sleep was lost listening about the courthouse Marvin was building. Furthermore, it was Chief Judge Marvin Jones

who petitioned Congress for a statutory definition of the Court of Claims as a constitutional court. He made a double-eagle, securing not only a statute but an opinion by the Supreme Court holding the claims court a constitutional one.

A short while before his death I was asked to speak at a prayer breakfast dedicated to Judge Jones. In my talk I reminded the audience of the declaration of Daniel Webster that justice was the great interest of man on earth; that those who worked to strengthen its foundations and to raise its spires higher and higher in the sky would be blessed by that great Judge who looked down upon and gave us life. Judge Jones, I said, would be so blessed for his lifetime of devotion. He replied with his Ode to Life:

> Life, we've been long together
> Thru pleasant and thru cloudy weather
> 'Tis hard to part when friends are dear
> Perhaps I will cast a sigh; a tear
> Then steal away; give little warning.
> Choose thine own time—
> Say not goodnight!
> But in some brighter clime
> Bid me, good morning!

CHIEF JUDGE COWEN: I consider that my friendship and close association with Judge Marvin Jones, which extended over a period of more than 35 years, have been among the greatest privileges of my lifetime. Since I knew him longer than any other employee or judge of the court, it was planned that I would speak for the court and trace his illustrious career in the Congress, in the War Food Administration and in the Court of Claims. However, Congressman Mahon and Justice Clark have covered the subject so well that I shall limit my remarks to a brief statement regarding his service to the court. I may not be a wholly impartial witness, but in my opinion, Marvin Jones did more for the Court of Claims than any other Chief Judge in the history of the court. His contributions were many but I shall mention only a few.

He enlarged the powers of the court and improved its procedures by obtaining the repeal of some old laws that were so archaic they were embarrassing, and by securing the enactment of new statutes that were badly needed for the efficient conduct of the court's business. He initiated and pre-

sided over the most thoroughgoing revision of the court's rules of practice that had been undertaken since its creation. In 1953, at his urging, the Congress enacted a statute declaring that the Court of Claims is a court which had been created under Article III of the Constitution. This legislation considerably enhanced the standing of the court, since it had long been considered a legislative court created under Article I of the Constitution.

As the former Chief Justice of the Supreme Court, Earl Warren, said at the dedication ceremony in September 1967, "Judge Jones is the father of this great building." Certainly he deserves most of the credit for persuading the Congress to appropriate the funds for the construction of this courthouse which we and the Court of Customs and Patent Appeals are privileged to occupy.

In addition to his accomplishments in behalf of the court as its Chief Judge and principal administrative officer, I think Marvin Jones was a great judge—not only because he worked diligently to find and apply the law in the cases he decided, but also because he had a keen understanding of human nature, a tolerance for the weaknesses of mankind, a compassion for the disadvantaged and an almost unerring instinct for justice. He was a religious man who kept his bible on his desk and referred to it frequently. He was also an avid reader of a wide variety of literature, ranging from the philosophy of Tacitus and Marcus Aurelius to the orations of Robert G. Ingersoll. He searched the writings of men of all ages to find those gems of wisdom which he considered to be expressed in simple but beautiful language, and many of his selections found their way into his opinions. He told me that the most eloquent statement he had read about death was contained in a speech made by John J. Ingalls, a former senator from Kansas, at the death of a friend. Since Judge Jones admired it, I would like to read this extract from Senator Ingalls' speech:

> In the democracy of the dead all men at last are equal. There is neither rank nor station nor prerogative in the republic of the grave. At this fatal threshold the philosopher ceases to be wise, and the song of the poet is silent. Dives relinquishes his millions and Lazarus his rags. The poor man is as rich as the richest, and the rich man is as poor as the pauper. * * * There the proud man surrenders

> his dignities, the politician his honors, the worldling his pleasures; the invalid needs no physician, and the laborer rests from unrequited toil. Here at last is nature's final decree in equity.

In closing this ceremony, I would like to thank all who have come here to join us in honoring our former Chief Judge, who served his country in all three branches of her government with complete devotion and acknowledged distinction.

We adjourn now in honor of Judge Marvin Jones.

DESIGNATION OF A JUDGE OF THE UNITED STATES COURT OF CLAIMS FOR SERVICE IN ANOTHER CIRCUIT

The Chief Justice of the United States, the Honorable Warren E. Burger, pursuant to the authority vested in him by Title 28, United States Code, designated and assigned the Honorable Robert L. Kunzig, a Judge of the United States Court of Claims, to act as a Circuit Judge of the United States Court of Appeals for the Fourth Circuit for the period June 8, 9, 10 and 11, 1976, and for such additional time in advance thereof to prepare for the holding of such court or thereafter as may be required to complete unfinished business.

C. CLYDE ATKINS, ET AL. v.
THE UNITED STATES

No. 41–76

LOUIS C. BECHTLE, ET AL. v.
THE UNITED STATES

No. 132–76

CERTIFICATE TO THE SUPREME COURT OF THE UNITED STATES

On May 27, 1976, pursuant to 28 U.S.C. § 1255(2), the Court of Claims by certification requested review by the Supreme Court in the matter of the above-identified cases in which the 82 United States District and Circuit Judges named therein allege that they have suffered an unconstitutional deprivation of earnings. The judges of the Court of Claims are unanimously of the view that Pub. L. 93–512, 88 Stat. 1609, taken literally, requires each of them to disqualify himself in these cases, because each has an interest in the subject matter of the controversy that could be substantially affected by the outcome of the proceeding, and they are uncertain as to whether the pre-existing "doctrine of necessity" should be read into the statute as an implied exception. Accordingly, the court certified the following question and respectfully requested the Supreme Court to give appropriate instructions thereon and certify and transmit the same to the Court of Claims for its guidance in the disposition of these cases:

> In view of the express provisions of Pub. L. 93–512 and the resolutions of the Judicial Conference as set forth above [referring to adoption by the Conference of Canon 3C.(1)(c) of the Code of Judicial Conduct of the American Bar Association, and resolution that Canon 3D should be stricken from the Code as adopted by the Conference so that a judge's disqualification on account of his financial interest may not be waived by agreement of the parties], are the judges of the Court of Claims required

to disqualify themselves in these cases, or does the "doctrine of necessity" authorize and require the judges of the Court of Claims to hear and decide these cases?

On June 21, 1976 the Supreme Court, by Order, dismissed the certificate [426 U.S. 944]. On August 10, 1976 the Court of Claims entered an order that these cases be heard by the court *en banc* on the October 1976 Calendar.

NOTICE CONCERNING PUBLICATION OF THE COURT'S HISTORY AND BIOGRAPHIES OF THE JUDGES

Judge Marion T. Bennett and his secretary, Miss Dorothy I. Butts, after a year of research have succeeded in collecting the pictures of all 47 judges who have served the Court of Claims in the years 1855–1976, inclusive. The pictures, which they have presented to the court, are presently on display in the second floor lobby just outside the main courtroom. The pictures will be included in a subsequent edition of these bound reports of the court accompanying biographies of the judges which have been prepared by Judge Bennett and Miss Butts in commemoration of the nation's bicentennial. The biographies will comprise Part I of the court's history. Part II of the history will relate the Constitutional development of the court.

CASES DECIDED
IN
THE UNITED STATES COURT OF CLAIMS

MAY 1, TO JULY 31, 1976, AND OTHER CASES
NOT HERETOFORE PUBLISHED

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535 F. 2d 5

NOVID COMPANY LTD. v. THE UNITED STATES

[No. 205-74. Decided May 12, 1976]

ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Court of Claims jurisdiction; nonappropriated funds; contract authorized under United States-Iranian agreements.—Plaintiff entered into a contract with the Army Corps of Engineers for construction of housing in Iran for use by the Imperial Iranian Gendarmerie at an agreed price payable in Iranian currency. The contract was authorized by agreements between the United States and Iran specifying, *inter alia* that payments under the contract were to be limited to a special account of the Corps of Engineers established in the Foreign Trade Bank of Iran. The funds were proceeds of sales of American commodities in Iran, which proceeds were loaned back to the Iranian Government under the terms of the Agricultural Trade Development and Assistance Act of 1954. Following completion of work under the contract, plaintiff asserted certain claims for increases. Plaintiff seeks reimbursement respecting those claims not allowed by the contracting officer or by the Iranian Head of Plan Organization. It is *held* that since Congress has manifested its intent that costs such as those involved here are not reimbursable out of general appropriations, this court is without jurisdiction to entertain plaintiff's claim. Defendant's motion for summary judgment is allowed and the petition is dismissed.

Court of Claims jurisdiction; nonappropriated fund instrumentality. [1] A contract sued on in this court under 28 U.S.C. § 1491 must be one which could be satisfied out of appropriated funds. Where the subject contract was entered into under the authority of agreements between the United States and Iran which limited contract payments to a loan account established in the Foreign Trade Bank of Iran, and

214-954—77——3

the enabling legislation did not authorize expenditure of appropriated funds but limited liability to funds derived from sale of goods in foreign commerce and loaned to the foreign government, this court is without jurisdiction to entertain a claim for reimbursement of additional costs incurred in performance of the contract.

Courts ⊂⊃ 449(1)

Stephen N. Abrams for plaintiff. *Herman M. Braude*, attorney of record.

James F. Merow, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before SKELTON, KASHIWA, and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

This Government contract case comes before us on defendant's motion for summary judgment filed September 26, 1975, and the opposition thereto. Plaintiff on February 20, 1964, entered into a contract with defendant, acting through the Army Corps of Engineers. Contract No. DA–92–144–Eng–188 was executed on standard form 23 and provided that the contractor would construct certain housing in Iran for use by the Imperial Iranian Gendarmerie, at an agreed price payable in Iranian currency, equal to about $900,000. The contract contained a modified disputes clause providing for an appeal of a contracting officer's finding of fact to a unit of the Iranian Government—"Head of Plan Organization, Government of Iran" (HPO).

This construction contract had been authorized by two "country-to-country" agreements between the United States and Iran dated April 11 and April 27, 1963, which provided, *inter alia*, that funds supplied to the Iranian Government by the United States for construction financing would be deposited in a separate account of the Corps of Engineers in the Foreign Trade Bank of Iran. Article X of both country-to-country agreements specified that payments under the contract were to be limited to this special account:

> * * * In no event will the Corps of Engineers take any action which will require funds exceeding those made available, which include contract price plus a con-

> tingency reserve * * *. The Corps of Engineers will have no authority to otherwise change the plans and specifications.

The parties tell us that these funds were the proceeds of sales of American commodities in Iran, which proceeds were being loaned back to the Iranian Government under the terms of the Agricultural Trade Development and Assistance Act of 1954, § 104(g), 68 Stat. 456. This statute specifically permits the use of foreign currency accounts "[t]o promote multilateral trade * * * and other economic development * * * by loans" to foreign countries. 7 U.S.C. § 1704(f) (1970).

Performance of the work was completed and accepted in due course, whereupon plaintiff through Iranian counsel asserted several claims for increase against the contracting officer. The contracting officer entered his decision on April 11, 1968, allowing a single upward price modification of $5,640. On May 5, 1968, plaintiff gave its notice of appeal to HPO, which entered its decision on August 10, 1968, allowing some additional 1,890,000 rials of the 28,400,000 claimed. On November 12, 1971, the then contracting officer (a successor) wrote to plaintiff closing out the contract, stating that HPO had advised "that they have settled with you the claims on the subject contract." A petition was filed in this court on June 11, 1974.

Defendant raises two questions for our consideration. First, we are asked whether this court has subject matter jurisdiction under 28 U.S.C. § 1491 (1970) where the funding source of the contract sued upon was money loaned to the Iranian Government by the United States but not directly out of appropriated funds. Alternatively, the Government would have us decide whether the decision of the HPO (the appellate entity designated in the contract to review contracting officer findings of fact) is entitled to finality in this court, or is subject to review under the terms of the Wunderlich Act, 68 Stat. 81, 41 U.S.C. §§ 321, 322 (1970).

We turn now to defendant's contention that we are without subject matter jurisdiction, since the contract in no event could obligate appropriated funds. This issue is dispositive of the claim. Defendant relies on *Kyer* v. *United*

States, 177 Ct. Cl. 747, 369 F. 2d 714 (1966), *cert. denied*, 387 U.S. 929 (1967).

In *Kyer* the court concluded that it was without jurisdiction of a claim based on a contract funded by nonappropriated funds. In dismissing the petition the court said:

> The jurisdiction of this court under the Tucker Act [footnote omitted] encompasses "any claim against the United States: * * * founded upon any express or implied contract with the United States; * * *." While the terms of this statute are broad, its words must be read in conjunction with and must be regarded as limited by another statute which provides that our judgments are paid only from appropriated funds. [Ftnt. omitted; 28 U.S.C. § 2517 (1964).] Thus, to remain within the framework of our jurisdiction, it is essential that the contract sued on be one which could have been satisfied out of appropriated funds. It is not enough to say, as plaintiff does, that his contract was one to which the United States was a party. To be actionable *in this court*, that contract must be one which, in the contemplation of Congress, could obligate public monies. [Citation omitted.] If Congress has indicated that public funds shall not be involved, we cannot grant the relief requested. * * *. [177 Ct. Cl. at 751–52, 369 F. 2d at 717–18; emphasis in text.]

Examining the governing legislation the court could find "no basis for inferring that public funds might be used to pay the commission which plaintiff was allegedly promised." 177 Ct. Cl. at 752, 369 F. 2d at 718. While noting the apparent harshness of the rule, the court felt constrained to dismiss the petition.

Subsequent decisions have developed the law applicable to contracts of nonappropriated-fund activities. In *Butz Eng. Corp.* v. *United States*, 204 Ct. Cl. 561, 499 F. 2d 619 (1974), we held that Congress did not intend to insulate appropriated funds from the liabilities of the Postal Service. In *Breitbeck* v. *United States*, 205 Ct. Cl. 208, 500 F. 2d 556 (1974), we decided that although the St. Lawrence Seaway Development Corporation was eventually to become self-financing, Congress intended to carry the project out of appropriated funds. Thus, the court declined to dismiss plaintiffs' claims for back pay.

More recently, we dismissed a petition on the nonappropriated-fund-activity ground in *McCloskey & Co.* v. *United States*, 208 Ct. Cl. 697, 530 F. 2d 374 (1976). There plaintiff sought to maintain a Wunderlich Act suit in this court, taking exception to the decision of the District of Columbia Contract Appeals Board. The contract in dispute was for the construction of what is now known as Robert F. Kennedy Stadium in the District of Columbia. Funding for this project was to come from a bond issue of the D.C. Armory Board, and the authorizing legislation as we construed it limited payment of claims to funds so raised. The court looked to *Kyer*, *supra*, as controlling authority in dismissing the petition. In *Hughes Aircraft Co.* v. *United States*, 209 Ct. Cl. 446, 478–79, 534 F. 2d 889, 909 (1976), we declined to dismiss a patent infringement suit, finding that although the United States was to be reimbursed by the United Kingdom for all amounts expended in development of the Skynet II satellite program, regular, appropriated funds were intended by Congress to be used pending such reimbursement for the procurement of material and services. In that case we could "find no indication that Congress 'wished to cut the Skynet II program entirely loose from the Treasury or from appropriated funds.'" *Id* at 483, 534 F. 2d at 912. In the instant case, however, Congress unambiguously has manifested its intent that costs such as those under the Iranian construction contract are not reimbursable out of general appropriations.

Turning to the instant case, defendant emphasizes the fact that the funds used to construct this Iranian housing were the property of the Iranian Government, and not of the United States. The parties agree that these funds were the proceeds of a loan from the United States to Iran. In defendant's view this fact alone requires dismissal under *Kyer*.

Plaintiff responds by saying that we must look beyond the form of the transaction to its substance. It emphasizes the following principal contentions: (1) Each of the intended uses of foreign currency set down in the authorizing legislation are of a sort "normally supported by appropriated funds." (2) The foreign currency accounts themselves, which are loaned to Iran "represent the proceeds from the sale of

Government-owned commodities acquired by payment of appropriated funds." (3) The United States Agency for International Development (USAID), a signatory to the country-to-country agreements, was an appropriated-fund activity. (4) The Army Corps of Engineers, an appropriated-fund activity, was charged with overall administration of the contract, including virtually exclusive custody and control of the funds. (5) Authority was given to the Corps of Engineers, an appropriated-fund activity, to award the contract. (6) Plaintiff places principal emphasis on its contention that in the event of a default by the Iranian Government, any payments out of the loan proceeds in the control of the Corps of Engineers would "effectively represent payment by the United States from public moneys." (7) Plaintiff seeks to distinguish *Kyer* on the ground that, in the case at bar, Congress has not indicated any prohibition against involvement of public funds. Plaintiff finds such a prohibition in *Kyer* in two respects: (a) The contracting committee was not the type of agency which normally contracted on behalf of the United States, and (b) funding derived exclusively from committee constituents, not appropriated funds. Plaintiff summarizes its position as follows:

> * * * Plaintiff submits that where a contract is entered into by the United States through an appropriated fund instrumentality, utilizing funds derived from the sale of United States-owned commodities originally acquired with appropriated funds, sufficient incidence of involvement of appropriated funds are demonstrated to satisfy this Court's jurisdiction * * *.

We think that plaintiff is glossing over the test set down in *Kyer* v. *United States*, *supra*. The question we must decide is whether "the contract sued on * * * [is] one which could have been *satisfied* out of appropriated funds"—"one which, in the contemplation of Congress, could obligate public monies." (Emphasis supplied.) 177 Ct. Cl. at 751, 369 F. 2d at 718. This is not such a contract. Article X of both country-to-country agreements strictly limited contract payments to the Iranian Government loan account established in the Foreign Trade Bank of Iran. Moreover, the enabling legislation, 7 U.S.C. § 1704(f) (1970), states that the funds provided are to take the form of a loan. The statute does not authorize

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the expenditure of appropriated funds. It is evident that Congress did not intend to authorize a pledge of the entire credit of the United States. Rather, it sought to limit liability to a definite fund of foreign currency derived from sale of goods in foreign commerce and loaned to a foreign government. Appropriated funds were wholly insulated from liability. In these circumstances the conclusion is legally irresistible that the contract was not "one which, in the contemplation of Congress, could obligate public monies." *Kyer*, *supra*. The factors cited by plaintiff are irrelevant. We do not think that Congress has invested us with jurisdiction to entertain this suit. In light of this holding, it is unnecessary to reach other issues raised by the parties. Defendant's motion for summary judgment is allowed. The petition is dismissed.

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535 F. 2d 8

AIRMOTIVE ENGINEERING CORP. v. THE UNITED STATES

[Nos. 43–74 & 151–74. Decided May 12, 1976]

ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

Renegotiation; redetermination of excessive profits; value engineering incentive awards.—During performance of its contract with the Air Force, plaintiff made certain recommendations as a consequence of which defendant realized savings in the neighborhood of $20 million. Plaintiff was given value engineering incentive awards of $6.2 million as provided in the contract. The Renegotiation Board concluded that the award payments constituted renegotiable "receipts and accruals" subject to the Renegotiation Act. In moving for summary judgment, plaintiff seeks de novo determination by the court that the award payments are not subject to renegotiation within the provisions of said Act. It is *held* that since the payments represent "receipts and accruals" received under the terms of a renegotiable contract, they are subject to renegotiation under the clear terms of the Act. Plaintiff's arguments that the awards were not contractually required, were unilaterally made by defendant and were merely a part of Government savings do not change this conclusion. This interpretation should not destroy contractor initiative in developing cost reduction programs because under 50 U.S.C. App. § 1213(e) at trial the trial judge is required to take the nature of the awards into consideration in making his excessive profits evaluation. Furthermore, this conclusion does not create a conflict

Syllabus

between the Renegotiation Act and the Armed Services Procurement Regulations. Plaintiff's motion for summary judgment is denied and the case is remanded to the trial judge for further proceedings.

Statutes; construction and operation; administrative interpretation.

[1] A long-standing administrative interpretation of a statute is entitled to a great deal of weight, particularly where the agency regulations follow statutory guidelines.

Statutes ⇐ 219(3)

Statutes; construction and operation; ordinary meaning of terms.

[2] Where a statute is unambiguous, the wording shall be given its plain and commonly understood meaning.

Statutes ⇐ 188

Contracts; estoppel; United States Government; unauthorized act of Government agent.

[3] The United States is not estopped to deny the authority of its agents, and one who deals with the Government assumes the risk that the officials with whom he deals have no authority. Thus, a contention that the United States is estopped from renegotiating value engineering incentive awards because various Department of Defense officials have taken the position that such awards are not profits under the Renegotiation Act is unpersuasive since the authority to develop renegotiation policy and interpret the Act resides in the Renegotiation Board and the courts, not in the Department of Defense.

Estoppel ⇐ 62(2)

Contracts; misrepresentation; representations of law.

[4] One who relies upon a legal interpretation by a Government official assumes the risk that it is in error.

United States ⇐ 70(1)

Renegotiation; redetermination of excessive profits; receipts and accruals; value engineering incentive awards.

[5] Value engineering incentive award payments received or accrued by a contractor represent monetary benefits under the terms of a renegotiable contract, and are subject to renegotiation within the contemplation of 50 U.S.C. App. § 1213(e) and Renegotiation Ruling No. 3, 32 C.F.R. § 1499.1–3 (1975), despite the fact that unadulterated savings to the Government resulted. Such payments are not unilateral awards since under the terms of the contract the Government has no discretion as to the amounts due the contractor.

War and National Defense ⇐ 59

Renegotiation; redetermination of excessive profits; receipts and accruals; value engineering incentive awards.

[6] To encourage savings, value engineering incentive award contract clauses are to be construed liberally to spur contractors to develop Government cost reduction programs. Congress recognized and resolved the problem that the "all receipts and accruals" sec-

tion might discourage contractor incentive by instructing the Renegotiation Board and the Court of Claims to consider such incentive awards on the merits of any renegotiation decision via 50 U.S.C. App. § 1213(e) (1970). Thus, while value engineering incentive awards cannot be excluded from de novo excessive profits determination on a motion for summary judgment, at trial the law requires this court to take the nature of the awards into consideration in making its excessive profits evaluation.

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Roger N. Boyd, attorney of record for plaintiff. *Donald C. Holmes, Jr.*, *Jones, Day, Reavis & Pogue*, of counsel.

Frances L. Nunn, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Don W. Crockett*, the Renegotiation Board, of counsel.

Before COWEN, *Chief Judge*, NICHOLS and KUNZIG, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

In these combined contract renegotiation cases of first impression, plaintiff comes before the court seeking a determination that certain value engineering (VE) incentive awards received from defendant are not subject to renegotiation within the provisions of the Renegotiation Act (the Act). Because the VE awards were received by plaintiff under a contract subject to renegotiation, we deny plaintiff's motion for summary judgment.

On January 12, 1968, plaintiff and the Department of the Air Force entered into a one-year service contract for the repair of jet engine blades. The contract contained a VE incentive clause providing for payment of a ten percent award to plaintiff based on Government savings in property, operations or logistical support costs.[1] The contract also

[1] The applicable portions of the VE clause provided:

"(f)(1) In the event that an accepted cost reduction proposal results in a projected net reduction in ascertainable costs in such areas as Government-furnished property (other than Government-furnished material under this contract), operations, or logistic support which exceeds any increase in acquisition cost, the contract price or fee, as applicable shall be increased by ten percent (10%) of the projected net reduction in ascertainable collateral costs * * *." [*Airmotive Engineering Corp.*, ASBCA No. 17139, 74-1 BCA ¶ 10,517, 49,829, 49,833 (1974)].

granted plaintiff a fifty percent award for any savings related to Government-furnished material under the contract.[2]

In March of 1968, plaintiff made several recommendations to defendant calculated to reduce the high amount of jet engine blade scrappage incurred during normal repair procedures. Defendant adopted the recommendations and reaped a considerable savings. After years of disagreement and three Armed Services Board of Contract Appeals decisions, plaintiff received some $6.2 million in VE awards.

Subsequently, the Renegotiation Board (the Board) concluded that the VE awards constituted renegotiable "receipts and accruals" subject to the Act. The Board determined that plaintiff had realized $2.2 million in excessive profits for fiscal years 1969 and 1970. Plaintiff then brought the present action before the Court of Claims for *de novo* determination of excessive profits represented by the VE awards.

Plaintiff enters a motion for summary judgment contending that the VE awards are not subject to the Act. Plaintiff also requests oral argument. Defendant opposes the summary judgment motion, arguing that the VE awards are contract payments contemplated by the Renegotiation Act. The court agrees with defendant at this stage of the case and, therefore, denies plaintiff's summary judgment motion.

Plaintiff enters a multi-phased argument that the VE awards should not be held subject to renegotiation primarily on the basis that the VE awards are not "profits" subject to the Act. In support of this premise, plaintiff contends: (1) the payments were not contractually required, (2) the awards were merely a "unilateral" compensation made to plaintiff by defendant, (3) the VE incentives were merely a part of Government savings, (4) to subject the VE awards to renegotiation would destroy contractor incentive and (5) any interpretation subjecting the awards to renegotiation would conflict with Armed Service Procurement Regulations (ASPRs).

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[2] "(f) (2) In the event that an accepted cost reduction proposal results in a net reduction in the amount of Government-furnished material under this contract * * * the contract price or fee, as applicable, shall be increased by fifty percent (50%) of the net savings estimated to accrue to the Government in the acquisition of items under this contract * * *." *Id.*

Plaintiff's theory cannot prevail.

Plaintiff's main argument is that the VE awards are not "profits" subject to the Renegotiation Act. However, such a contention "glosses over" the clear terms of the Act itself. Renegotiation specifically applies to contracts with (among others) the Department of the Air Force (50 U.S.C. App. § 1213(a) (1970)) "to the extent of the amounts received or accrued by a contractor * * * on or after the first day of January 1951." 50 U.S.C. App. § 1212(a) (1970). Neither party disputes the fact that plaintiff's contract with the Air Force was subject to the provisions of the Act.

Under the Act, "excessive profits" are to be eliminated by including a "renegotiation clause" in each Government contract. Contractors are thereby required to agree "to the elimination of excessive profits through renegotiation." 50 U.S.C. App. § 1214(1) (1970). In the instant case, neither party claims that such an agreement was excluded from the January 12, 1968 contract. The question presented for resolution then becomes whether or not plaintiff's VE awards were "excessive profits" subject to renegotiation.

Congress carefully defined what it intended by use of the phrase "excessive profits." Subsection 1213(e) provides:

> The term 'excessive profits' means the portion of the profits derived from contracts with the Departments and subcontracts which is determined in accordance * * * [with the Act] to be excessive * * *. [50 U.S.C. App. § 1213(e) (1970)].

Subsection 1213(f) further clarifies the meaning of profits:

> The term 'profits derived from contracts with the Departments and subcontracts' means the excess of the *amount received or accrued under such contracts* and subcontracts over the costs paid or incurred with respect thereto and determined to be allocable thereto. [50 U.S.C. App. § 1213(f) (1970) (emphasis added)].

In short, the Act clearly contemplates that *all* "receipts and accruals" obtained as a result of performance of renegotiable contracts will be part of the renegotiation formula.

An early interpretation of the Renegotiation Board further buttresses the conclusion that Congress intended to subject value engineering incentive awards to renegotiation.

Renegotiation Ruling No. 3, 32 CFR § 1499.1–3 (1975) (originally promulgated June 1, 1961) provides:

> when a value engineering recommendation made by a contractor is adopted, the contract price is adjusted upward to allow the contractor a greater profit than he would otherwise have realized. The amount of the award thus becomes a receipt or accrual to the contractor pursuant to the terms of the contract, and, if the contract is subject to the [A]ct, the amount of the award is a renegotiable receipt or accrual * * *. [32 CFR § 1499. 1–3(b) (1975)].

Indeed, such a "long standing administrative interpretation" is entitled to a great deal of weight, *Commissioner* v. *Noel's Estate*, 380 U.S. 678, 682 (1965); *Fox* v. *United States*, 145 Ct. Cl. 186 (1959), *cert. denied*, 361 U.S. 887 (1959), particularly, as in the instant case, where it clearly follows statutory guidelines.

In the present action, the VE award payments obviously constituted amounts received or accrued by plaintiff under the terms of a renegotiable contract for the repair of jet engine blades. Under the clear provisions of the Act, plaintiff's VE awards were subject to renegotiation and plaintiff's argument that the VE awards were not excessive profits must fail.

Plaintiff's remaining arguments represent guides to interpretation of the Renegotiation Act. As defendant properly points out, where a statute is unambiguous, such "wording * * * shall be given its plain and commonly understood meaning." *Sharples* v. *United States*, 209 Ct. Cl. 509, 533 F. 2d 550 (1976). *See also Sode* v. *United States*, 209 Ct. Cl. 180, 531 F. 2d 531 (1976); *Selman* v. *United States*, 204 Ct. Cl. 675, 680, 498 F. 2d 1354, 1356 (1974); and *Prudential Ins. Co.* v. *United States*, 162 Ct. Cl. 55, 65, 319 F. 2d 161, 166 (1963). However, even assuming arguendo that the Act is ambiguous with respect to whether or not plaintiff's VE awards are subject to its terms (which it is not), plaintiff's attempts to exclude the awards from renegotiation still fail.[3]

[3] In its reply brief, plaintiff raises the argument that defendant is estopped from renegotiating the VE awards because various Department of Defense officials have taken the position that the incentive awards are not profits under the Renegotiation Act. Plaintiff contends that it relied to its detriment on

(1) Contractual requirements:

Plaintiff first attempts to exclude the VE awards from renegotiation by suggesting that they were not contractually required. Such a contention ignores the plain fact that the awards were paid pursuant to subsection (f) of the VE clause of the January 12, 1968 contract. *See* notes 1 and 2, *supra.* In fact, plaintiff obtained the greater portions of its VE awards as a result of litigation before the Armed Services Board of Contract Appeals.[4] In short, the VE awards were contractually mandated.

(2) Unilateral VE awards made by defendant:

Plaintiff's second attempt to avoid renegotiation of the awards centers on its contention that the VE payments were merely unilateral awards made by defendant. Again, plaintiff passes over the crucial fact that under the clear terms of plaintiff's contract with defendant, there was no discretion left to the Government as to VE amounts due plaintiff. Defendant was contractually required to pay plaintiff ten percent of any net savings on property, operations or logistical support costs and fifty percent of any net savings on material costs. *See* notes 1 and 2, *supra.* Contrary to plaintiff's position, the VE awards were not made unilaterally by defendant, but took place pursuant to a bilateral contract.

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such policy in developing its cost saving proposals in the instant case. Plaintiff may not use an estoppel argument.

Primarily, plaintiff fails to assert that the DOD officials had authority to bind the Government. The United States is not estopped to deny the authority of its agents, *Putnam Mills Corp.* v. *United States,* 202 Ct. Cl. 1, 479 F. 2d 1334 (1973); *California-Pac. Util. Co.* v. *United States,* 194 Ct. Cl. 703, 720 (1971), and one who deals with the Government assumes the risk that the officials with whom he deals have no authority, *Federal Crop Ins. Corp.* v. *Merrill,* 332 U.S. 380, 384 (1947). Plainly, the authority to develop Renegotiation policy and interpret the Act, resides in the Renegotiation Board and the courts, not in the Department of Defense. Plaintiff was, therefore, not entitled to rely on the unauthorized interpretations of the Act by DOD officials.

Moreover, even if the representations by DOD officials were authorized, they constituted, if anything, a legal opinion of the ramifications of the Act in the incentive award area. One who relies upon a legal interpretation by a Government official assumes the risk that it is in error. *Cf. Mills* v. *United States,* 187 Ct. Cl. 696, 700, 410 F. 2d 1255, 1257 (1969). Again, plaintiff cannot argue that defendant is bound by a mistaken legal interpretation of the Renegotiation Act by DOD officials.

[4] As stated by the BCA: "In this appeal Airmotive asks for $1,505,819.05 alleged to be *due it under the above contract* as a result of adoption by the Government of certain value engineering change proposals." *Airmotive Eng. Corp. supra* at 49,830 (emphasis supplied).

(3) Government savings:

Plaintiff's third argument is that VE awards were never intended to be subjected to renegotiation because they represent only plaintiff's share of what constituted an unadulterated savings to the Government. It is true that plaintiff's VE awards were paid from Government savings and as such represented no added costs to the taxpayer. However, regardless of the source of the VE funds, they did represent monetary benefits received by plaintiff pursuant to a Government contract and as such, are renegotiable receipts contemplated by the Act.

The weakness of plaintiff's "Government benefit" argument is put into clearer focus if we carry it one step further. Using the same logic, plaintiff could argue that since the VE awards represented only its share of Government savings (thus costing nothing to the taxpayer), the payments should not be subject to income tax. Surely no court would so find. The VE payments clearly are subject to income tax treatment. They should equally be subject to renegotiation, regardless of their source.

(4) Incentive:

Plaintiff's fourth attack has some merit. Plaintiff claims that subjecting the payments to renegotiation would prove counterproductive because the VE award program's goal is to encourage contractors to save money for the Government. According to plaintiff, by putting the VE awards through renegotiation, such contractor initiative will be discouraged.

Absent certain provisions of the Renegotiation Act, plaintiff's contractor incentive argument would have a great deal of force. Indeed, to encourage savings, VE award clauses are to be construed liberally to spur contractors to develop Government cost reduction programs. *Cf.*, *Dravo Corp.* v. *United States*, 202 Ct. Cl. 500, 480 F. 2d 1331 (1973); *B. F. Goodrich Co.* v. *United States*, 185 Ct. Cl. 14, 398 F. 2d 843 (1968). In fact, we admit to a strong sympathy for plaintiff's overall position. The Renegotiation Act itself recognizes the problem of contractor incentive. In plain language it specifically deals with the basic philosophy of cost savings.

> In determining excessive profits *favorable recognition must be given* to the efficiency of the contractor or sub-

> contractor, with particular regard to attainment of quantity and quality production, *reduction of costs*, and economy in the use of materials, facilities, and manpower; and in addition, there shall be taken into consideration the following factors: * * *
>
> * * * * *
>
> (4) Nature and extent of contribution to the defense effort, including *inventive and developmental contribution* * * *. [50 U.S.C. App. § 1213(e) (1970) (emphasis supplied)].

See also 32 CFR § 1499.1–3(b), *supra*.

It is therefore clear that Congress recognized and resolved the problem that the "all receipts and accruals" section of the Act might discourage contractor incentive. However, rather than totally exclude incentive profits from the Act as plaintiff suggests, Congress clearly instructed the Renegotiation Board and the Court of Claims to consider such incentive awards *on the merits* of any Renegotiation decision. What this portends for plaintiff in the instant case is that the VE awards cannot be excluded from the *de novo* excessive profits determination at this stage of the proceedings. *But at trial, the law requires the trial judge to take the nature of the awards into consideration in making his excessive profits evaluation.*

In short, discouragement of contractor incentive is adequately dealt with in the Act and does not provide any reason to hold that plaintiff's VE awards should be excluded *at this stage*.

(5) Conflict between the Act and ASPRs:

Plaintiff's final position is that an interpretation bringing VE awards within the Act will create an impermissible conflict between the Renegotiation Act and the ASPRs because the Act and the ASPRs must be read *in pari materia*.

This argument is merely a restatement of plaintiff's "incentive destruction" contentions. Plaintiff creates an apparent conflict by citing the "incentive goal" provisions of the ASPRs.[5] It is true as plaintiff notes that all "laws, rules and

[5] *See, e.g.*, ASPR § 1.1703–1(b) (32 CFR § 1.1703–1(b)):

"* * * [A] strong incentive tied to definitely assured savings will induce maximum contractor efforts to realize the full savings potential of value engineering * * *."

regulations must be read in the context of other laws pertaining to the same subject matter and should be interpreted in the manner which is most reasonable and logical in light of the aims and the designs of the total body of law of which it is a part." *Cohen* v. *United States*, 181 Ct. Cl. 400, 406, 384 F. 2d 1001, 1006 (1967). However, there is no conflict present in our instant decision between the incentive goal in the ASPR VE provisions and the Renegotiation Act. Plaintiff would create such a conflict by urging that to subject VE awards to renegotiation destroys incentive. However, as expressly noted in part (4) *supra*, Congress saw the potential for such conflict and resolved the problem in the Act itself. § 1213(e), *supra*. In short, subjecting plaintiff's VE awards to renegotiation creates no conflict between the Act and the ASPRs.

In conclusion, in this contracts renegotiation case plaintiff's summary judgment motion attempts to have certain value engineering incentive award payments excluded from the excessive profit determination required by the Renegotiation Act. However, since the payments represented "receipts and accruals" obtained by plaintiff pursuant to a renegotiable contract, it is clear that the Act contemplated subjecting them to renegotiation. Plaintiff's arguments that the awards were not contractually required, were unilaterally made by defendant, and were merely a part of Government savings, do not change this conclusion. Further, the instant interpretation should not destroy contractor initiative because the law requires the trial judge to take the nature of the awards into consideration in making his excessive profits evaluation. This conclusion also does not create a conflict between the Renegotiation Act and the Armed Services Procurement Regulations. At this threshold stage of the case we are merely holding that under the clear terms of the Renegotiation Act, plaintiff's VE incentive awards are subject to renegotiation.

Accordingly, for the foregoing reasons, plaintiff's summary judgment motion is denied and the case is hereby remanded to the trial judge for further proceedings consistent with this opinion.

Syllabus

535 F. 2d 14

GIMBEL BROTHERS, INC. v. THE UNITED STATES

[No. 491–71. Decided May 12, 1976]

OPINION

Taxes; method of accounting; installment method; revolving charge accounts; election; dealers in personal property.—This suit is before the court on a stipulation of facts. Plaintiff seeks to recover statutory interest on the difference between the amounts it paid in income tax and the lesser amounts it claims it should have paid for fiscal years ended January 31, 1952 through January 31, 1966. In 1952 plaintiff, selling merchandise through department stores, elected the installment method. For the years in issue it reported on the installment method its income from installment sales, except income from some of its sales on the revolving credit plan. It was then the policy of the Internal Revenue Service that sales on such a plan did not qualify for installment reporting; this policy was changed in 1963. Plaintiff contends that its 1952 election under Sec. 44(a) of the Internal Revenue Code of 1939 and Sec. 453(a) of the 1954 Code required it to report all installment sales income including that from rotating charge accounts on the installment method, that it made a mistake in not reporting its rotating charge account sales on the installment method but in reporting on the accrual method, that it wants to correct its mistake, not to change its election, and that a taxpayer who elects one of several permissible accounting methods is bound by its election even if it applies the method in an erroneous fashion, provided the method elected, if properly applied, would clearly reflect income. It is *held* (1) that plaintiff's 1952 election of the installment method was required to be all inclusive so that its reporting of its rotating charge account income on the accrual method during 1952 through 1966 was erroneous, there being no division of revolving charge accounts into separate accounts; and (2) that its recomputation of its returns did not constitute a retroactive change of accounting method, but rather a permissible correction of an error. Judgment is entered for plaintiff with the amount of recovery to be determined pursuant to Rule 131(c).

Taxes; methods of accounting; installment method; dealers in personal property.

[1] The purposes of the installment method of reporting income from sales of personal property under the Internal Revenue Code are to defer payment of taxes on gains until the proceeds of the sale have been received and to avoid the difficult and time-consuming effort of appraising the uncertain market value of installment obligations.

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Opinion of the Court

Taxes; methods of accounting; installment method; dealers in personal property.

[2] Where a dealer elects to report income from the sale or other disposition of personal property on the installment plan, the election is for the installment method, not for which items will be accounted for under the installment method once that method is elected. This is in contrast to the treatment of sales of real property and casual sales of personal property where an installment method election applies only to a particular sale and separate elections are available for each sale.

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Taxes; methods of accounting; election; installment method; dealers in personal property.

[3] A dealer in personal property who reports some installment sales on the installment method, has thereby elected to report all installment sales on that method, and his failure to report some such sales in conformity with his election must be corrected in a claim for refund or an amended return. Where plaintiff for fiscal years ended January 31, 1952 through January 31, 1966 reported on the installment method all of its income from installment sales, except income from a portion of its sales on the revolving credit plan reported on the accrual method because Internal Revenue Service policy was that the revolving credit plan did not qualify for installment reporting, and where this policy was changed in 1963, since plaintiff was not permitted to report its rotating charge accounts on the accrual method, any such reporting was an error and did not constitute an election. By filing its timely claim for refund properly reporting income from rotating charge accounts on the installment method, there was no change in accounting method but merely correction of an error to properly report according to the installment method election previously made.

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John Wilcox, attorney of record, for plaintiff. *Chadbourne, Parke, Whiteside & Wolff*, *George E. Zeitlin*, and *Leslie J. Schreyer*, of counsel.

Robert N. Dorosin, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Robert Markham*, of counsel.

Before COWEN, *Chief Judge*, DAVIS and KASHIWA, *Judges*.

KASHIWA, *Judge*, delivered the opinion of the court:

This action comes before us on a stipulation of facts. The essential facts stipulated are recited below. This action arises

under the Internal Revenue Codes of 1939 and 1954 for the taxable years ended January 31, 1952, through January 31, 1966, inclusive.

We hold for the plaintiff for reasons hereafter stated.

Plaintiff is engaged in the business of selling merchandise through department stores. It qualified as a "dealer in personal property" within the meaning of the installment sale provisions of the Internal Revenue Codes of 1939 and 1954. In its return for 1952 plaintiff elected to use the installment method to report income from its installment sales as allowed under § 44(a) of the 1939 Code (hereafter § 44(a)). For 1952 and all the other years in issue, plaintiff reported on the installment method all of its income from installment sales, except income from some of its sales on the revolving credit plan. It was then the policy of the Internal Revenue Service that sales on the revolving credit plan did not qualify for installment reporting. The Service's policy was later changed in response to a court decision [1] and plaintiff's erroneous reporting was later corrected in timely filed refund claims.

During the years in issue plaintiff regularly sold merchandise for cash and under numerous credit plans. The names and details of the credit plans varied from store to store and from year to year. In its books and records plaintiff grouped its credit plans into several categories which it labeled as follows:

1) regular retail accounts
2) regular deferred payment accounts
3) general merchandise credit coupon accounts
4) rotating charge accounts
5) continuous budget accounts [2]

[1] *Consolidated Dry Goods Co.* v. *United States*, 180 F. Supp. 878 (D. Mass. 1960). The change was effected by amended regulations issued in T.D. 6682, 1963–2 Cum. Bull. 197.

[2] 1) Regular retail accounts were general charge accounts properly reported on the accrual method.

2) Regular deferred payment accounts required execution of a separate contract for each sale of merchandise. Payment was made in two or more installments. Plaintiff retained a security interest in the item. This account income was properly reported on the installment method.

3) General merchandise credit coupon accounts allowed a customer to obtain coupons or certificates which he could then use to purchase merchandise as if the coupons were cash. On receipt of his billing statement, the customer had the option of paying the full cash price for all coupons received or of

(Continued)

Each of those categories included several credit plans with varying details but with common basic characteristics.

In filing its returns plaintiff reported on the installment method its income from categories 2, 3, and 5 but not its income from category 4. Only the tax treatment of plaintiff's rotating charge accounts is in controversy. Plaintiff corrected its erroneous reporting of sales on rotating charge accounts by filing timely claims for refund for all the years in issue. The claims were either denied or not acted upon within the prescribed time and plaintiff instituted this action.

The parties agree that all of plaintiff's income from sales on its rotating charge accounts is taxable. The question is only the *years* in which plaintiff should have included that income in its taxable income. Plaintiff contends that it should have reported that income on the installment method and, therefore, by reporting it on the accrual method it prepaid its taxes on that income in years before the taxes were due. Plaintiff seeks interest on the difference between the amounts it paid and the lesser amounts it claims it should have paid.

The issues involved in this case are the following:

1) Was plaintiff's 1952 election of the installment method required to be all inclusive so that plaintiff's reporting of its rotating charge account income on the accrual method during 1952 through 1966 was erroneous?

2) Did plaintiff's recomputation of its returns constitute a retroactive change of accounting method for which the Commissioner's consent is required?

(Continued)
making monthly installment payments of a portion of the balance due. This account income was properly reported on the installment method.

4) Rotating charge accounts and continuous budget accounts had substantially similar characteristics. Continuous budget accounts apparently were an outgrowth of regular deferred payment accounts, which may explain why plaintiff reported this income on the installment method. The income tax treatment of income from the continuous budget accounts is not at issue here.

5) Both rotating charge accounts and continuous budget accounts established a credit limit for each customer. When an account had an outstanding balance, the customer was required to make a monthly payment of at least a specified amount. Payments were not applied to liquidate any particular sale but reduced the balance, which consisted of the unpaid portion of all purchases. A customer was not required to execute a separate contract for each purchase.

In its income tax return for 1952, plaintiff elected to report its income from installment sales on the installment method in accordance with § 44(a).[3] Section 453(a)(1) of the 1954 Code (hereafter § 453(a)(1)) is substantially identical.[4] Plaintiff contends that its election applied to all of its sales on the installment method and to all years here at issue.

At this point it is well that we examine the purposes of the installment reporting sections above mentioned. In *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 503 (1948), the Court stated:

> The installment basis of reporting was enacted, as shown by its history, to relieve taxpayers who adopted it from having to pay an income tax in the year of sale based on the full amount of anticipated profits when in fact they had received in cash only a small portion of the sales price. *Another reason was the difficult and time-consuming effort of appraising the uncertain market value of installment obligations.* * * * [Footnote omitted. Emphasis supplied.]

Similarly, in *Baltimore Baseball Club, Inc.* v. *United States*, 202 Ct. Cl. 481, 485, 481 F. 2d 1283, 1285 (1973), we stated the purposes to be as follows:

> * * * the basic purposes of which are to defer payment of tax on gains until the proceeds of sale with which to pay the tax have been received and also to avoid *what may be the difficult requirements of valuing the obligations of the purchaser in a closed transaction.* * * * [Emphasis supplied.]

We observe that there are two purposes for the statute: first, to defer the payment of taxes on gains until the proceeds of the sale have been received, and second, to avoid the difficult and time-consuming effort of appraising the

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[3] SEC. 44. INSTALLMENT BASIS.

"(a) DEALERS IN PERSONAL PROPERTY.—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price."

[4] Section 44(a) of the 1939 Code was in effect for plaintiff's taxable years 1952 through 1954. Section 453(a) of the 1954 Code was in effect for the remaining taxable years in issue, 1955 through 1966.

uncertain market value of installment obligations. The first reason is, of course, obvious but we also consider the second reason to be very material in the present-day world of vast department store operations, as in the present case. In the discussion to follow, we must keep in mind that the statute not only defers payment of taxes until the money is received but it also avoids a very practical consideration where thousands or millions of accounts are involved.

The statute and regulations in effect for 1952 govern the interpretation and effect of plaintiff's election. It is plaintiff's position that once a dealer elected the installment method, it could not discontinue using it or change to another method in a subsequent year unless it requested and received the consent of the Commissioner.

The term "installment plan" as applied to dealers in personal property was not defined in § 44 of the 1939 Code, in the regulations issued thereunder, or in the legislative history of § 44 or its predecessors.[5] Nor was it defined in the 1954 Code or the regulations in effect prior to 1963. During a period commencing prior to the first year at issue and terminating on October 15, 1963, it was the policy of the Internal Revenue Service that only sales under the "traditional installment plan" qualified as sales on the installment plan eligible for installment reporting by dealers.

In 1960 the United States District Court for the District of Massachusetts rejected the Service's position and held that sales under the revolving credit plan were installment sales which qualified for reporting under both § 44(a) and § 453 (a). *Consolidated Dry Goods Co.* v. *United States*, *supra* note 1. The court there at 881 held as follows:

> The evidence offered by plaintiff clearly establishes that in the practice and usage of the retail trade the term "installment plan" is broad enough to include plaintiff's plan. In trade usage any plan involving an arrangement for the sale of merchandise with payment to be made in two or more periodic payments is an installment plan. Numerous text books were cited to show that this is the accepted trade definition and that revolving credit plans in their various forms are considered in the retail trade to be installment plans. A similar usage prevails in the

[5] *Consolidated Dry Goods Co.* v. *United States*, *supra* note 1, at 880–81.

> field of statistics relating to retail trade. The Federal Reserve Board follows this usage in compiling its statistics of business activity. Thus the Federal Reserve Bulletin for April 1953 explains, on page 341, that "installment credit includes all consumer credit held by financial institutions and retail dealers which is scheduled to be repaid in two or more installments. Revolving credit, budget, or coupon accounts are treated as installment credit rather than as charge accounts because they involve scheduled repayment on a periodic basis."

On October 15, 1963, the regulations under § 453 were amended to accept the holding of the *Consolidated Dry Goods* case and to define the two types of installment sales eligible for installment reporting: sales under the traditional installment plan and sales under a revolving credit plan.

A traditional installment plan is defined in the regulations, as amended in 1963, in terms of two identifying characteristics: a separate contract for each sale and the dealer's retention of a security interest.[6] Plaintiff's sales on its regular deferred payment accounts were sales on the traditional installment plan. A revolving credit plan is one under which the customer agrees to make monthly payments of a portion of the outstanding balance of his account. Payments are generally not applied to liquidate any particular sale but simply reduce the balance due on the account. The parties agree that plaintiff's sales on its rotating charge accounts, its continuous budget accounts,[7] and its general merchandise credit coupon accounts [8] were sales on the revolving credit plan.

Under both § 44(a) and § 453(a), plaintiff contends that its 1952 election required it to report all installment sales income in accordance with the installment method. However, plaintiff admits that it improperly reported some of that income on the accrual method, its income from rotating charge accounts. For years under the 1939 Code it was held in *Consolidated Dry Goods Co.* v. *United States*, *supra* note

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[6] Treas. Reg. § 1.453–1(a)(1) (1963):

"A traditional installment plan usually has the following characteristics:

"(i) The execution of a separate installment contract for each sale of personal property, and

"(ii) The retention by the dealer of some type of security interest in such property."

[7] Treas. Reg. § 1.453–2(d)(1) (1963).

[8] *W. T. Grant Co.* v. *Comm'r*, 483 F. 2d 1115 (2d Cir. 1973), *cert. denied*, 416 U.S. 937 (1974).

1, that sales on the revolving credit plan were simply a type of installment sale. The taxpayer in that case was not required to make a separate election to report those sales on the installment method because its election of that method was held to include revolving credit sales. In 1963 the regulations were amended to provide that for years governed by the 1954 Code a dealer who makes sales under both the traditional installment plan and the revolving credit plan may elect to report on the installment method: (1) all of his sales under both plans; (2) only his sales under the traditional installment plan; or (3) only his sales under the revolving credit plan. Treas. Reg. § 1.453–1(a)(1) (1963).

At this point it is well that we incorporate from plaintiff's brief the position as well as the alternative it takes:

> In 1963, regulations under section 453(a) of the 1954 Code were amended to reflect the Commissioner's acceptance of the *Consolidated Dry Goods* holding that revolving credit sales are installment sales. The amended regulations are applicable only to 1954 Code years, not for 1952, the year of Gimbels' election, yet defendant's brief persists in attempting to apply the 1963 regulations to interpret Gimbel's election. [Footnotes omitted.]
>
> The length and frequency of defendant's invocation of those regulations render it incumbent on us to point out to the Court that the 1963 regulations continue to require a dealer to make an all-inclusive election for his traditional installment sales, his revolving credit sales, or both. Thus, even if those regulations were applicable or relevant to interpret the effect of Gimbel's election, which they are not, that election clearly covered all of Gimbels' installment sales.
>
> The 1963 regulations incorporate in the tax law two industry terms first mentioned in the *Consolidated Dry Goods* case: "traditional installment sales" and "revolving credit sales." Under the 1963 regulations, a dealer who elects the installment method *in or after 1954* is permitted to elect that method for *all* of his traditional installment sales, or for *all* of his revolving credit sales, or for *all* of both types of sales. The 1963 regulations do not allow an election for less than all of either type of sale. [Footnote omitted. Emphasis in original.]
>
> Yet, notwithstanding the clear language of Gimbels' election and of the 1963 regulations, defendant contends

that Gimbels' election should be interpreted as an election of the installment method for all 5 of its traditional installment plans, and for 7 of its 12 revolving credit plans, but not for its 5 remaining (and, concededly, substantially identical) revolving credit plans. Defendant further asserts that this selective "election" which defendant created out of whole cloth is permissible under the 1963 regulations, and binding on Gimbels. [Footnote omitted.]

Defendant's unfounded arguments are most easily refuted not only by the explicit language of the 1963 regulations themselves * * * but also by the reasoning underlying those regulations. After all, if a dealer were permitted to elect the installment method for whichever of his installment plans he desires, as defendant here claims, why do the 1963 regulations not provide that a dealer may elect the installment method for "any one or more" of his installment plans, instead of dragging in a reference to the two broad classes of installment sales.[9]

* * * * *

Accordingly, even if the 1963 regulations did govern the scope of Gimbels' 1952 election, which they do not, that election was, as a matter of law, all-inclusive for

[9] Plaintiff further points out the following from defendant's own publication:

"Indeed, the Internal Revenue Service's published 'official interpretation' of the 1963 regulations even more explicitly demands an all-inclusive election. Since 1964, each edition of the *Tax Guide for Small Business* has stated that a dealer who makes both traditional installment sales and revolving credit plan sales may elect the installment method for his revolving credit plan sales, or for his traditional installment sales, or for both, but not for less than all of either category:

" 'If you are a dealer regularly engaged in the sale of personal property on the installment plan, or revolving credit plan, you may report *all of your income from such sales* either on the installment method or on the accrual method * * *.

* * * * *

" '[Y]ou must indicate in your return that the installment method is being adopted and specify the type or types of sales (installment plan or revolving credit plan or both) included within such election.'*

"Similar language appears in both editions of another Internal Revenue Service publication: CREDIT SALES BY DEALERS IN PERSONAL PROPERTY (IRS Publication No. 512, 1972 edition at page 2; 1975 edition at page 1)."

"**TAX GUIDE FOR SMALL BUSINESS*, IRS Publication No. 334, 1965 edition at page 16 (1964); 1966 edition at page 12 (1965); 1967 edition at page 12 (1966); 1968 edition at page 18 (1967); 1969 edition at page 14 (1968); 1970 edition at page 14 (1969); 1971 edition at pages 12–13 (1970); 1972 edition at pages 15–16 (1971); 1973 edition at page 18 (1972); 1974 edition at page 19 (1973); 1975 edition at page 19 (1974). (Emphasis added.) Beginning with the 1970 edition, the first sentence of the above quotation was changed to read '* * * you may report your income from such sales. * * *' The quoted language also has other immaterial variations in some editions."

both Gimbels' traditional installment sales and its revolving credit sales. It, therefore, covered the rotating charge accounts here at issue.

With relation to plaintiff's position above expressed, we observe that in *Pacific National Co.* v. *Welch*, 304 U.S. 191 (1938), the taxpayer reported income from sales of property according to the deferred payment method, although it could have used the installment method. The Court held that the taxpayer was not entitled to have the income computed according to the installment method where it is not shown that the deferred payment method correctly applied would not clearly reflect its income. The Court stated:

> * * * There is nothing to suggest that Congress intended to permit a taxpayer, after expiration of the time within which return is to be made, to have his tax liability computed and settled according to the other method. By reporting income from the sales in question according to the deferred payment method, petitioner made an election that is binding upon it and the commissioner. [Footnote omitted. At 194–95.]

Plaintiff argues that a taxpayer who elects one of several permissible accounting methods is bound by his election even if he applies it in an erroneous fashion, provided that the method elected, if properly applied, would clearly reflect income.

Defendant argues that under the holding of *Pacific National*, plaintiff is bound by its election and its consistent reporting of its rotating charge accounts on the accrual method. Defendant's argument is that since plaintiff's 1952 election was not required to be all inclusive, its actual reporting of its rotating charge accounts on the accrual method for all of the years in issue must be deemed a legally binding election of such method. Plaintiff finds support in the same case by arguing that it made an election in 1952, it made a mistake in not reporting its rotating charge account sales on the installment method, and now it wants to correct its mistake, not change its election.

Defendant's argument focuses on whether the 1952 election was required to be all inclusive. An examination of the provisions of the 1939 Code and of the 1954 Code prior to the 1963

regulations does not resolve the problem. Nor is it resolved by an examination of the 1963 regulations which assume a factual situation in which a merchant has one traditional installment plan and one revolving credit plan. Defendant states that plaintiff did not maintain a revolving credit plan but, rather, utilized three revolving credit plans. Reporting of one plan on the installment method did not foreclose reporting another plan on the accrual method. Defendant also states that a taxpayer is permitted to use a hybrid accounting method provided that the combination of accounting methods clearly reflects income and is consistently used. And defendant argues that an erroneous accounting method, consistently applied, cannot be changed.

Plaintiff's argument to rebut defendant's selective election proposition is that if the installment method could be selected for some installment plans and not others, then an electing dealer could easily have avoided the double tax imposed by § 44(c) of the 1939 Code. Although there has been much written on minimizing the impact of the double tax, no one has suggested selective election. Section 44(c) provided as follows:

> (c) CHANGE FROM ACCRUAL TO INSTALLMENT BASIS.—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

There would be a double tax, once when the total income was reported under the accrual method and again after the change in methods when the income from previous sales was reported under the installment method. Plaintiff argues that if defendant's theory of selective election is correct, a dealer would merely have had to change the names and a few details of any one or more of his credit plans sufficiently to make it a different plan and then elect the installment method only for the new plan. Under defendant's rationale the smallest changes would suffice for defendant argues that plaintiff's election covered its continuous budget accounts but not its

rotating charge accounts, even though the operations of those plans were, as defendant states in its brief, "virtually indistinguishable."

However, plaintiff continues, in over 50 years of double tax on electing dealers, no one has proposed such selective election. Although a sizeable body of literature on the double tax has developed and although many of the articles and treatises discuss possible ways to minimize the impact of the double tax,[10] no one has suggested that a dealer who wants to elect the installment method without incurring the double tax simply do so at a time when he initiates one or more new installment plans, including sufficiently modified old plans, and restrict his election of the installment method to the new or modified plans only.

Commentators have agreed that a dealer's election of the installment method applies as a matter of law to all of his installment sales. We refer to the following authors:

> * * * [A] dealer who elects to report income on the installment basis must do so for all installment sales during the year, while in the case of a "casual" sale of personal property the taxpayer has a separate option with respect to each transaction. * * * [B. BITTKER, FEDERAL INCOME, ESTATE AND GIFT TAXATION 696 (1st ed. 1955); 655 (2d ed. 1958); 815 (3rd ed. 1964); B. BITTKER and L. STONE 846 (4th ed. 1972).]
>
> * * * Sellers of real estate and casual sellers of personal property may elect separately for each sale, but a dealer's election is binding from year to year in respect of all installment sales * * *. [Moser, *Installment and Deferred Payment Sales*, N.Y.U. 9th INST. ON FED. TAX. 997, 998 (1951).]
>
> Installment dealers must be consistent each year and must report all or no sales under the installment method, whereas, casual sellers of personalty or sellers of realty have an option as to each sale and may report income from one sale under the installment method and income on the next sale under their usual method of accounting. [Anderson, *The Taxation of Installment Sales Includ-*

[10] One way is to sell to a bank the installment receivables which resulted from sales reported on the accrual method and then elect the installment method. See *City Stores Co. v. Smith*, 154 F. Supp. 348 (E.D. Pa. 1957), and the Commissioner's following of that decision in Rev. Rul. 59-343, 1959-2 Cum. Bull. 136.

ing Section 44(d) Problems, U. SO. CAL. 1953 TAX INST. 341, 346 (1953).]

We hold that the 1952 election was required to be all inclusive. We have carefully read § 44(a) and § 453(a). From the very language used the election was intended to be all inclusive. The statutes state that a dealer "may return as income therefrom [from the sale or other disposition of personal property on the installment plan] in any taxable year" a proportion of the installment payments received in that year. The election is for the installment method, not for which items will be accounted for under the installment method once that method is elected. This is in contrast to the treatment of sales of real property and casual sales of personal property where an installment method election applies only to a particular sale and separate elections are available for each sale.

In *Mayer & Co.*, 9 B.T.A. 815, 822 (1927), the Board stated:

> * * * When [the taxpayer dealer] changed its method of reporting from the accrual method to the installment method, it was called upon to report all of its income from installment sales under that method. It must treat all such items of income consistently. It cannot return under both methods. To follow both methods would result in distortion of income. * * *

In *Franc Furniture Co.*, 1 B.T.A. 420 (1925), the taxpayer deducted only part of its expenses when reporting income on the installment basis. It was entitled to deduct all of its expenses when incurred, regardless of how it reported income. The taxpayer submitted amended returns but the Commissioner regarded them as changing its basis of reporting income and they were not acceptable. The Board held that the amended returns did not change the method of reporting income but merely claimed additional expense deductions.

In *Ivan D. Pomeroy*, 54 T.C. 1716 (1970), the petitioner, who had sold his residence, stated in his income tax return for the year of sale: "Electing to treat as an installment sale * * *." 54 T.C. at 1720. The Commissioner determined that the taxpayer had erroneously applied the installment method in computing his gain, and the taxpayer then sought

to report the gain on the "open contract" method. The court held, however, that despite his erroneous computation, the petitioner had elected the installment method:

> * * * Here, petitioner did make a permissible election on his return and only his computation of gain is disputed by the respondent. Having thus made that election, petitioner may not now change his position. [54 T. C. at 1724.]

The well-accepted principle that an election of a permissible elective method is valid despite the taxpayer's incorrect application of that method is not unique to the installment sale area. Just as plaintiff's election of the installment method required it to report all of its installment sales on that method, so an election to take a credit rather than a deduction for foreign income taxes paid requires a taxpayer to claim a credit for all such income taxes paid in the year of election. He cannot claim a credit for some and a deduction for others. Int. Rev. Code of 1954, § 275(a)(4).

In an analogous area the Internal Revenue Service ruled that a taxpayer's deduction of *any* research expenditures with respect to a project constitutes a binding election to deduct *all* such expenditures for that project for the year of election and for all subsequent years. Accordingly, the Service ruled that a taxpayer who deducted some such expenses but failed to deduct others "should file a timely claim (Form 843) or amended return and claim the additional research or experimental expenses for the year or years in which they were omitted." Rev. Rul. 58–74, 1958–1 Cum. Bull. 148.

The same conclusion holds true for a dealer who reports some installment sales on the installment method: he has thereby elected to report *all* of his installment sales on the installment method, and his failure to report some such sales in conformity with his election must be corrected in a claim for refund or an amended return. This is what plaintiff did.

The fact that the party making an election misunderstands the tax consequences of the elected method and hence misapplies it also does not invalidate the election. In *Rosenfield* v. *United States*, 156 F. Supp. 780 (E.D. Pa. 1957), *aff'd*, 254 F. 2d 940 (3d Cir. 1958), *cert. denied*, 358 U.S. 833, an executor stated in an estate tax return that he elected to

have the assets valued on the optional valuation date. In preparing the return the attorney for the estate, upon whom the executor relied in signing the return,

> * * * mistakenly believed that by electing the optional valuation date the estate would be permitted to pick and choose the advantageous date for each individual asset. Accordingly, under the column headed "Value under option" on the return he entered the valuation at the date of death for each asset which had increased in value within a year after death, and the year after death valuation for each asset whose value had decreased or remained unchanged during that period. * * * [156 F. Supp. at 782.]

The court rejected the argument of the administrator [the deceased executor's successor] that an attempted application of the election to only a portion of the assets of the estate was not a valid election of the optional valuation date. It held that the statement in the return clearly indicated an election of the optional valuation date; hence, the improper failure to value all assets as of that date was not an election of such treatment (which was impermissible) but, rather, an erroneous manner of applying the optional valuation method elected. The administrator was thus required to value *all* of the estate's assets on the optional valuation date and could not change the election.

Where a taxpayer makes an election but applies the elected method in an erroneous manner, the courts have consistently allowed the taxpayer to correct the error in an amended return or in a refund claim. In *Ray W. Torrey Co.* v. *Commissioner*, 84 F. 2d 659 (6th Cir. 1936), *rev'g on procedural issue*, 1934 P-H B.T.A. Memo. Dec. ¶ 34,283, the taxpayer had filed a return "on the installment basis although not strictly in accordance with the respondent's regulations" (1934 P-H B.T.A. Memo. Dec. ¶ 34,283). A year later it filed an amended return showing substantially less income, correctly computed under the installment method. The Board of Tax Appeals rejected the Commissioner's argument (the same one he makes here) that the taxpayer was attempting to change to the installment method in its amended return. The Board held, and the Sixth Circuit agreed, that, while the original return was not technically correct under the install-

ment method, the taxpayer nevertheless intended to and did file its original return on that method. Accordingly, on remand the Board of Tax Appeals found that the taxpayer had no taxable income for the year in question and was entitled to a refund (*Ray W. Torrey Co.*, 1936 P-H B.T.A. Memo. Dec. ¶36,396).

Applying the above rules to the instant case, it is clear that plaintiff was not permitted to report on the accrual method its income from sales on rotating charge accounts, for a dealer who elected the installment method was required to report all income from its installment sales on the installment method. Accordingly, plaintiff could not have elected and did not elect to report income from its rotating charge accounts on the accrual method; but, rather, such reporting was an error. By filing its timely claims for refund properly reporting that income on the installment method, plaintiff corrected its error.

Plaintiff had to report all of its installment sales on the installment method. The sales in the rotating charge accounts were installment sales. There is no division of revolving charge accounts into separate accounts. All revolving charge accounts are to be treated the same. Since the continuous budget accounts were reported on the installment method, so, too, must the rotating charge accounts. Plaintiff's method was not a hybrid nor was it an erroneous accounting method. There was one method of accounting, the installment method. An error was made by not applying the method to the rotating charge accounts. There was no change in accounting methods but, rather, the correction of an error.

Plaintiff alternatively argues that even if it had purported to elect to report its rotating charge accounts on the accrual method, such reporting was impermissible and, therefore, did not bar a later election to report those accounts on the installment method. In view of our disposition of the case, it is not necessary to take up this argument.

Defendant's alternative argument, if plaintiff's 1952 election was required to be all inclusive, is that plaintiff is still not entitled to recompute retroactively the income from sales under its rotating charge plan on the installment method

after it had consistently reported the income from such sales on the accrual method. Plaintiff answers this with Rev. Rul. 75–56, 1975–1 Cum. Bull. 98, which contrasted two situations in which taxpayers attempted to correct their improper capitalization of certain deductible expenses. In one situation the erroneous treatment occurred for ten years and the statute of limitations had expired for seven of those years. The taxpayer's attempt to amend its returns for only the last three years was held to be a change of accounting method from the method used in the closed years.

> X [a domestic corporation], on the other hand, by permitting the period for amending its first return to expire, has adopted a method of accounting within the meaning of section 1.446–1(a) of the regulations, to capitalize such expenses.
>
> Accordingly, the taxpayer in the instant case, having adopted a method of accounting to capitalize the items in question, is precluded from changing that method for the years 1971, 1972, and 1973. * * * [Rev. Rul. 75–56, 1975–1 Cum. Bull. 98.]

In the other situation dealt with in Rev. Rul. 70–539, 1970–2 Cum. Bull. 70, the taxpayer amended its returns to correct the erroneous accounting method in all three years in which the method was used, including the initial years of such use. The Internal Revenue Service stated in Rev. Rul. 75–56:

> * * * The holding [in Rev. Rul. 70–539] was based on a decision that such taxpayer had never made a valid binding election to capitalize the expenses involved. By amending its first return, the taxpayer in Rev. Rul. 70–539 was not changing a method of accounting used in previous years, since it had no previous existence. In effect, by timely amending of its first return, such taxpayer was adopting a method of accounting within the meaning of section 1.446–1(a) of the regulations.

In the instant case plaintiff is amending its first return in which it made its election. If under Rev. Rul. 70–539 a taxpayer could amend a return where an election was not made in order to make the election, it is our view that plaintiff here can amend a return to properly report according to the election it has already made.

CONCLUSION OF LAW

Upon the foregoing opinion, which contains the essential findings of fact as stipulated by the parties, the court concludes as a matter of law that judgment is entered for plaintiff with the amount of recovery to be determined pursuant to Rule 131(c).

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535 F. 2d 624

ALOYSIUS A. J. FLUTE v. THE UNITED STATES

[No. 38-75. Decided May 12, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Military pay; Court of Claims jurisdiction to review courts-martial; constitutional challenge.—Plaintiff seeks back pay and correction of his military records, claiming that his special court-martial conviction for assaulting a Korean civilian in July 1972 should be overturned because (1) the trial and review thereof by the convening authority and by the Office of the Judge Advocate General were constitutionally unsound in that the judge failed to give the jury an instruction on self-defense, the Government lost or misplaced two pages of the court-martial Record of Trial, and the post-trial review did not contain a summary of evidence, an opinion as to the adequacy of the evidence, etc. which precluded an intelligent review of the trial; (2) that the Air Force Board for Correction of Military Records acted arbitrarily and capriciously when it considered a JAG advisory opinion on whether to grant plaintiff a hearing without permitting plaintiff to comment and that the Board violated its own regulations, 32 C.F.R. §§ 865.12 and 865.13, by failing to prepare a written record of its decision; and (3) that the Board denied plaintiff equal protection of the laws under 10 U.S.C. § 277 when it refused to allow him to comment on or rebut the JAG advisory opinion. It is *held* with respect to (1) that plaintiff's allegations do not rise to a constitutional level and accordingly this court does not have jurisdiction to review the court-martial proceeding; with respect to (2) that the Board's use of an advisory opinion, given the broad scope of the Secretary's discretion in determining entitlement to a hearing, does not violate the due process clause, and that 32 C.F.R. §§ 865.12 and 865.13 apply only to Board hearings and not to the initial decision as to whether to permit a hearing, and since a hearing was not held in plaintiff's case, it cannot be said that the Board violated its own regulations; and as to

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(3) that plaintiff has not shown that he has suffered any equal protection injury. Accordingly, this court will not interfere with the Board's actions. The court raises the question *sua sponte* whether limitations on Correction Boards' jurisdiction involving review of court-martial convictions may pass through and limit this court's jurisdiction, as a possible alternative ground for deciding a case such as the instant one, and also gives notice that, for the future, counsel will be expected to discuss the vitality of the ideas expressed by the Attorneys General in 1948 and 1949 referred to in the opinion regarding applicability of Sec. 207 of the Legislative Reorganization Act of 1946 to court-martial convictions. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is allowed, and the petition is dismissed.

Military pay; courts-martial; Court of Claims jurisdiction to review.

[1] Because of the finality language of the Uniform Code of Military Justice, 10 U.S.C. § 876, this court has jurisdiction to review court-martial convictions, if at all, only where the alleged infirmities at the court-martial rise to a constitutional level. This court does not have the authority to retry the facts of a court-martial proceeding nor to act as a reviewing court of the decision of the court-martial tribunal.

Courts ⇐ 448

Military pay; courts-martial; constitutional challenge.

[2] In a suit for back pay in this court collaterally attacking a court-martial proceeding, plaintiff must make some showing, not merely an allegation, that he has been subject to constitutional unfairness.

Courts ⇐ 464(1)

Military pay; courts-martial; constitutional challenge.

[3] In light of Rule 30 of the Federal Rules of Criminal Procedure, failure of the presiding judge at a court-martial to give the jury an instruction on self-defense does not make the court-martial constitutionally unfair, particularly where the accused's counsel neither requested a self-defense instruction nor objected to the lack of an instruction. Military tribunals must be accorded reasonable scope for the exercise of judgment.

Armed Services ⇐ 47(6)

Military pay; courts-martial; review of courts-martial.

[4] The finality language of the Uniform Code of Military Justice means, with whatever else, that the military tribunal must be allowed a reasonable scope for the exercise of judgment in deciding just how much is necessary to be done to effectuate a constitutional right they are aware of and manifestly respect. Since neither 10 U.S.C. § 860 nor § 865(c) requires that the Staff Judge Advocate review of the accused's court-martial trial be evidenced by a written memorandum and where plaintiff has made no showing that he was prejudiced by the loss of two pages of the court-martial

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record of trial or that the review procedure was inherently unfair, his criticisms of lack of a memorandum and loss of two pages do not rise to a constitutional level, and accordingly are not within this court's review jurisdiction.

Courts ⇐ 448

Constitutional law; due process of law—Fifth Amendment; correction of military records.

[5] Due process of law is variable in concept. The procedures required by the due process clause depend upon the particular circumstance involved, the precise nature of the Government function and the type of "liberty" or "property" interest affected. The use by a Board for Correction of Military Records of an advisory opinion of the Judge Advocate General, given the broad scope of the Secretary's discretion as authorized in 32 C.F.R. § 865.7 in determining entitlement to a hearing on an application for correction, does not violate due process, absent a showing by the applicant that the denial of a hearing was arbitrary or capricious or that it was based on erroneous facts.

Constitutional Law ⇐ 255(3)

Military pay; correction of military records; review of application for correction; denial of application; findings.

[6] Since 32 C.F.R. § 865.7 provides three possible dispositions of applications for corrective action, including denial of an application without a hearing, in which event Sec. 865.7(c) provides that written findings are not required, in the absence of a hearing in plaintiff's case the failure of the Air Force Board for Correction of Military Records to prepare a written report of the findings or a summary was not a violation of its own regulations. 32 C.F.R. §§ 865.12 and 865.13 apply only to Board *hearings* and not to the initial decision as to whether to permit a hearing.

Armed Services ⇐ 23.1(1)

Constitutional law; equal protection of the law; correction of military records.

[7] While 10 U.S.C. § 1552(a) provides that the various correction boards function under procedures established by their respective Secretaries, there is no requirement that the regulation be identical for each service, the various Secretaries having discretion to determine the scope of the Board's review. Although one of the military services may recognize an applicant's right in proceedings for correction of his military record to an advisory opinion of the Judge Advocate General, the refusal of the Air Force Board for Correction of Military Records to allow plaintiff to comment on or rebut a JAG advisory opinion is not denial of equal protection of the law where plaintiff has not shown he suffered injury thereby; this court will not disturb such regulation procedure absent a showing of arbitrary or capricious action.

Constitutional Law ⇐ 242.1(3)

Richard P. Fox, attorney of record for plaintiff. *Max Gest*, of counsel.

Arlene Fine, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Peter A. T. Sartin* and *Stephen G. Anderson*, of counsel.

Before DAVIS, NICHOLS, and BENNETT, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

Plaintiff, Staff Sergeant Aloysius A. J. Flute, was tried for assaulting a Korean civilian on July 8, 1972, before a Special Court-Martial convened at Kunsen Air Base, Korea on August 31 and September 1, 1972. Flute was convicted and sentenced to a reduction in rank or grade, and was restricted to the limits of Kunsen Air Base for two months. The conviction and sentence were approved by the Commander of the 3rd Combat Support Group, the convening authority. Plaintiff applied three times to the Office of the Judge Advocate General (JAG) in accordance with Article 69 of the Uniform Code of Military Justice, 10 U.S.C. Sec. 869 (1970). Relief was denied on all three occasions.

Flute then filed an application on June 20, 1974, for correction of his military records with the Air Force Board for Correction of Military Records (BCMR) pursuant to 10 U.S.C. Sec. 1552. By letter dated October 10, 1974, plaintiff was advised that his application had been denied without a hearing because he "failed to establish a showing of probable error or injustice." Plaintiff thereafter filed suit in this court under 28 U.S.C. Sec. 1491, seeking back pay because of his reduced rank, and a correction of his military records by voiding his court-martial conviction.

Plaintiff's motion for summary judgment is based on three points: first, that the court-martial conviction should be overturned because the trial and review thereof were constitutionally unsound; second, that the BCMR acted arbitrarily and capriciously in violation of its own regulations and the due process clause of the Fifth Amendment to the Constitution; and third, that plaintiff was denied equal protection of the

laws under 10 U.S.C. Sec. 277. Defendant has cross-moved. We do not find any merit in plaintiff's contentions.

Plaintiff's first argument is that the court-martial proceeding was constitutionally unfair. The Supreme Court has held that this court has jurisdiction to review court-martial convictions, *if at all*, only where the alleged infirmities at the court-martial rise to a constitutional level. *United States* v. *Augenblick*, 393 U.S. 348 (1969). This is so because of the finality language of the Uniform Code of Military Justice, 10 U.S.C. Sec. 876 which states:

> The appellate review of records of trial provided by this chapter, the proceedings, findings, and sentences of courts-martial as approved, reviewed, or affirmed as required by this chapter, and all dismissals and discharges carried into execution under sentences by courts-martial following approval, review or affirmation as required by this chapter, are final and conclusive.

This court does not have the authority to retry the facts of a court-martial proceeding nor to act as a reviewing court of the decision of the court-martial tribunal. *Artis* v. *United States*, 205 Ct. Cl. 732, 506 F. 2d 1387 (1974).

Plaintiff contends that the judge failed to give the jury an instruction on self-defense and that there were irregularities in the review of the proceeding. The question is whether these alleged defects "rise to a constitutional level" as contemplated by the Supreme Court in *Augenblick*, *supra*. A plaintiff in this court must make some showing, not merely an allegation, that he has been subject to constitutional unfairness. *Gross* v. *United States*, 209 Ct. Cl. 70, 531 F. 2d 482 (1976). The Supreme Court phrased the issue as follows:

> * * * apart from trials conducted in violation of express constitutional mandates, a constitutionally unfair trial takes place only where the barriers and safeguards are so relaxed or forgotten * * * that the *proceeding is more a spectacle * * * or trial by ordeal * * * than a disciplined contest.* At 393 U.S. 356. (Emphasis supplied.)

Defendant's counsel neither requested a self-defense instruction nor objected to the lack of an instruction. The Federal Rules of Criminal Procedure, Rule 30, would bar a party from excepting to an instruction unless he objects

before the jury retires. In light of this rule, it would seem that a merely erroneous instruction does not deprive the accused of a constitutionally fair trial. Mere error in admitting or excluding evidence does not make a court-martial constitutionally unfair. Military tribunals must be accorded reasonable scope for the exercise of judgment. Plaintiff also alleged that there were constitutional defects in the post-trial review procedure, specifically that the Government lost or misplaced 2 pages of the court-martial Record of Trial, thus precluding an intelligent review of the trial. In its petition, plaintiff complained that the "post-trial review did not contain a summary of evidence, an opinion as to the adequacy of the evidence, the effect of any error or irregularity at trial, a specific recommendation as to the actions to be taken and specific reasons for opinions and recommendations."

A Record of Trial was prepared in plaintiff's case which was sent to the convening authority who approved the decision, as required by Article 60, 10 U.S.C. Sec. 860. Thereafter the Record was sent to the Staff Judge Advocate General, who reviewed the case in accordance with Article 65(c), 10 U.S.C. Sec. 865(c) (1970). Neither provision requires a written memorandum. The review was in accord with the regulations pertaining to *special* court-martials. Plaintiff has cited cases in his brief concerned with review procedures for general court-martials. Plaintiff was convicted by a special court-martial and therefore it is apparent that the proper regulations were followed. There is no showing that plaintiff was prejudiced by the loss of the two pages or that the review procedure was inherently unfair. The court-martial was not a "spectacle" nor a "trial by ordeal". Plaintiff's allegations do not rise to a constitutional level. Therefore, we do not have jurisdiction to review the court-martial proceeding. Moreover, since this is a non-constitutional issue and was raised at the military forums available to plaintiff, it should not be raised here again. The finality language of the statute means, with whatever else, that the military tribunal must be allowed a reasonable scope for the exercise of judgment in deciding just how much is necessary to be done to effectuate a constitutional right they are aware of and manifestly respect. *Gallagher* v. *United States*, 191 Ct. Cl. 546, 423 F. 2d 1371, *cert. denied*, 400 U.S. 849 (1970).

Plaintiff's second argument is that he was deprived of due process of law by the BCMR's review of the court-martial proceeding. Plaintiff avers that the BCMR acted in an arbitrary and capricious manner when it considered a JAG advisory opinion on whether to grant plaintiff a hearing, without permitting plaintiff to comment, and that the Board violated its own regulation by failing to prepare a written record of its decision.

Due process of law is variable in concept. The procedures required by the due process clause depend upon the particular circumstances involved, the precise nature of the Government function and the type of "liberty" or "property" interest affected. *Arnett* v. *Kennedy*, 416 U.S. 134, 155 (1974); *Goldberg* v. *Kelly*, 397 U.S. 254 (1970); *Cafeteria & Restaurant Workers Union* v. *McElroy*, 367 U.S. 886, 895 (1961).

A starting point in examining the requisites of due process in a BCMR proceeding is the statute, 10 U.S.C. Sec. 1552, which provides:

> (a) The Secretary of a military department, under procedures established by him and approved by the Secretary of Defense, and acting through boards of civilians of the executive part of that military department, may correct any military record of that department when he considers it necessary to correct an error or remove an injustice * * * Except when procured by fraud, a correction under this section is final and conclusive on all officers of the United States.

The denial of a hearing before the BCMR does not *per se* deprive plaintiff of due process. Plaintiff contends that he should have been able to review all the evidence before the BCMR. While it might or might not have been better practice to allow plaintiff to read the JAG advisory opinion, we do not think the Board's failure to do so amounted to a constitutional or statutory violation. In *Merson* v. *United States*, 173 Ct. Cl. 92 (1965), *on rehearing*, 185 Ct. Cl. 48, 401 F. 2d 184 (1968), we held, citing many cases, that a Correction Board rejecting a claim on medical grounds without a hearing, might obtain an opinion from the Surgeon General without advising the claimant.

In deciding without a hearing, the Board is in effect conducing an *ex parte* inquiry. If the JAG is asked for an

opinion this does not make him an adversary counsel to the claimant as plaintiff here supposes. The BCMR's review of a case is not an adversary proceeding. *Armstrong* v. *United States*, 205 Ct. Cl. 754 (1974). A hearing is not required by statute, but is within the BCMR's discretion. *Armstrong*, *supra; Newman* v. *United States*, 185 Ct. Cl. 269 (1968); *Hutter* v. *United States*, 170 Ct. Cl. 517, 345 F. 2d 828 (1965). If a hearing is granted, the Secretary has the discretion to determine the scope of review. *See*, *Biddle* v. *United States*, 186 Ct. Cl. 87 (1968). 32 C.F.R. Sec. 865.7 authorizes the Board to hold a hearing, order correction of records without a hearing or deny a hearing. The fact that that BCMR requested a legal opinion does not make its ultimate decision to deny a hearing any less valid. The Board could have denied plaintiff a hearing without seeking any legal advice. In *Weiss* v. *United States*, 187 Ct. Cl. 1, 408 F. 2d 416 (1969), we held that if the JAG desires to contribute to a decision on record correction he should submit his views to the Board. Plaintiff has not shown that the denial of a hearing was arbitrary or capricious or that it was based on any erroneous facts, as in *Hutter*, *supra*. Therefore we conclude that the BCMR's use of an advisory opinion, given the broad scope of the Secretary's discretion in determining entitlement to a hearing, does not violate the due process clause.

Further, plaintiff alleges that the BCMR violated its own regulations, 32 C.F.R. Sec. 865.12(c) and Sec. 865.13 by failing to keep a record of the proceedings. The BCMR recorded its determination to deny plaintiff's application without a hearing, the date of the decision, and by whom it was made, but did not prepare a written report of the findings or any summary. Plaintiff urges the court to apply 32 C.F.R. Sec. 865.12(c) and Sec. 865.13 to the case. Such an interpretation is inconsistent with the organizational division of the regulation. We agree with defendant's reading of the regulation: that 32 C.F.R. Sec. 865.12 and Sec. 865.13 apply only to Board *hearings* and not to the initial decision as to whether to permit a hearing.

Title 32 of the Code of Federal Regulations, Part 865, Subpart A, established procedures for the consideration, by the Secretary of the Air Force acting through a Correction

Board, of applications for the correction of military records. 32 C.F.R. Sec. 865.7 "Review of applications," provides three possible dispositions of applications for corrective actions: (1) correction of records without a hearing; (2) denial of the application without a hearing; and (3) authorization of a hearing. The regulations do not discuss the first alternative. The second alternative is considered in Sec. 865.7(b), which details the criteria for denying relief and Sec. 865.7(c) which provides that written findings are not required when an application is denied without a hearing. Nothing further is said about denial of an application without a hearing. 32 C.F.R. Sec. 865.7(c) clearly applies to the Board's determination not to grant plaintiff a hearing.

After explaining what is necessary for denial of an application, the regulation in subsequent sections details entitlement to a hearing, Sec. 865.8; conduct of a hearing, Sec. 865.10; action by the Board, Sec. 865.12; and action by the Secretary, Sec. 865.13. 32 C.F.R. Sec. 865.12(c) is part of the regulation covering action by the Board *after a hearing has been held.* If a hearing is not held in accordance with 32 C.F.R. Sec. 865.10, then 32 C.F.R. Sec. 865.12(c) does not apply. Since a hearing was not held in plaintiff's case, it cannot be said that the Board violated its own regulations.

Plaintiff's final argument is that the Board denied him equal protection of the laws when it refused to allow him to comment on or rebut the JAG advisory opinion since the Navy, operating a Correction Board under 10 U.S.C. Sec. 1552 recognizes an applicant's right to an advisory opinion. Plaintiff further argues that the Board violated 10 U.S.C. Sec. 277, which provides that "laws applying to both Regulars and Reserves shall be administered without discrimination; (1) among Regulars; (2) among Reserves; and (3) between Regulars and Reserves."

10 U.S.C. Sec. 1552 (a) provides that the various correction boards will function under procedures established by their respective Secretaries. There is no requirement that the regulations be identical for each of the services. This court has recognized that the various Secretaries have discretion to determine the scope of the Board's review. *See, Biddle, supra.* We will not disturb the regulation procedure absent

a showing of arbitrary or capricious action. *See*, *Winters* v. *United States*, 412 F. 2d 140 (9th Cir.), *cert. denied*, 396 U.S. 920 (1969). (10 U.S.C. Sec. 277 did not forbid the Marine Corps from requiring 100 percent attendance at its reservists drills although reservists in other branches of the armed forces were required to attend only 90 percent of the reserve drills). Plaintiff has not shown that he has suffered any equal protection injury. Therefore, plaintiff's third contention must be dismissed.

Plaintiff has not shown that the Board acted in an arbitrary or capricious manner, that its decision was unsupported by substantial evidence or that it failed to comply with its own regulations. Therefore, this court will not interfere with the Board's actions. *Dorl* v. *United States*, 200 Ct. Cl. 626, *cert. denied*, 414 U.S. 1032 (1973).

Plaintiff conceded that he could not by routing his case via the Correction Board to this court, confer on us jurisdiction to reverse the court-martial conviction for errors of a nature we could not, under *United States* v. *Augenblick*, *supra*, review if the case came to us otherwise. He expected we could remand to the Board if we could not reverse. We inquired from the bench whether any limitations on Correction Board jurisdiction exist, because of the fact that the determination complained of was a court-martial conviction. Except for the above concession, the parties briefed and argued the case as if that fact made no difference. Defendant reserved but did not reargue the point it has previously urged: if the grievance is a court-martial conviction, we have no jurisdiction at all. This is, of course, not the point we asked about. The Government contends that the finality principle under 10 U.S.C. Sec. 876 bars any collateral attack at all on a court-martial conviction in a civilian court except by habeas corpus. Our point may be considered a lesser included one. Limitations on Board jurisdiction may pass through and limit ours, so it is our duty to raise the question *sua sponte*. Since it would not affect the result here, however, we have decided this case in the previous pages, as the parties have briefed and argued it. We raise the jurisdictional point as a possible alternative ground for this decision

and as notice that, for the future, counsel will be expected to discuss it when more cases of this kind come before us.

The present 10 U.S.C. Sec. 1552, the statutory charter of Boards for Correction of Military Records, had its origin as Sec. 207 of the Legislative Reorganization Act of 1946, 60 Stat. 812, 837. Under date of February 24, 1947, 40 Op. Att'y Gen. 504, Attorney General Tom Clark advised the Service Secretaries of his views as to the application of the Act to court-martial convictions. He says that to effectuate the purpose of the Act to relieve Congress of a flood of private bills, it must be construed as including such convictions. However, it

> * * * cannot be construed as permitting the reopening of the proceedings, findings, and judgments of courts-martial so as to disturb the conclusiveness of such judgments, which has long been recognized by the courts. (At 508)

He cites *Ex Parte Reed*, 100 U.S. 13, 23 (1879).

> The correction of the record and the issuance of a new discharge [in lieu of a dishonorable one inflicted by court-martial sentence] may be regarded as acts of clemency, or in mitigation, precisely comparable in effect to a successful appeal to the Congress for relief by private act. (At 508).

He refers to the need for maintaining systems of courts-martial which will provide effective disciplinary measures as well as insuring justice to the individual.

> * * * It was clearly not the intention of the Congress to make mandatory, upon requests by interested parties, the indiscriminate and wholesale reexamination of discharges or dismissals by reason of sentences of general courts-martial. * * * Furthermore, section 207 is not to be regarded as superimposing a further means of review, freely available, upon the procedures previously set up. * * * (At 509).

The finality principle referred to was at that time judge made, but upon its being made statutory, the Attorney General reaffirmed and redeclared the above principles and their continued applicability, rejecting the idea that the finality language reduced the jurisdiction of Correction Boards by implication, 41 Op. Att'y. Gen. 49 (1949). These are con-

temporaneous pronouncements of high authority in the interpretation of the legislation they construe. In *Ray* v. *United States*, 197 Ct. Cl. 1, 453 F. 2d 754 (1972), we called the Clark opinion a "landmark" and accorded it great weight.

It would seem to follow if they are still the law, that the plaintiff here had the same standing before the Board as if he had been applying for clemency to the Congress, or for relief of a discretionary *certiorari* type. In either event, he had no legal right to demand that the Board correct errors, not amounting to Constitutional violations, and therefore a refusal such as here occurred would not vest us with jurisdiction even if we agreed that errors occurred. In an instance of Constitutional violation, the finality doctrine might permit an exception to the foregoing. It would follow that counsel rightly conceded that we could not reverse the Board merely because we thought we perceived errors in the court-martial procedure, so long as they were not of Constitutional dimensions. A complaint, not of a court-martial conviction but of *e.g.*, an administrative discharge, would stand on a different and much stronger footing when the complaint was against the doings of Administrative Boards, adverse and perhaps even punitive to the soldier but not criminal in the nature of their jurisdiction.

As a Clemency Board, the BCMR was privileged to conduct non-adversary *ex parte* inquiries except to the extent its own internal regulations provided otherwise. This would be true even if its inquiries related to the legality of the court-martial proceedings, a subject to which, in its discretion, it would be privileged to direct them even if it was not in legal theory conducting an appellate review. It would follow the complaints here about lack of Board due process are misdirected. On deciding without a hearing not to review a court-martial it is not required to provide due process, or to put the proposition in a more modern way, what process is due is not to be ascertained by reference to proceedings of other than a clemency character. It is not at the clemency phase of the case, after all the appellate review provided by the military system is concluded, that due process as in an adversary proceeding in the constitutional sense is required. The Board is exercising a legislative function, it might be

said, and is required to accord due process no more than a Congressional Committee would be.

Without information which Government counsel could provide, as to the vitality of the ideas expressed by Attorneys General in 1948 and 1949, in the present executive branch, we are unable to read and act on them with full confidence as the basis of our decisions. We ought not to be given, as here, only the option or Hobson's choice of pronouncing ourselves entirely without jurisdiction in any case involving a court-martial, or else giving the proceedings the extended and detailed review apparently assumed by both parties to be the alternative. The case would not have been appropriate for remand to the Board under the jurisprudence of this court prior to the reversal of our decision in *United States* v. *Testan*, 424 U.S. 392 (1976), in view of our having no fault to find with the Board's previous decision. That decision removes a remand from even arguable consideration.

Plaintiff's motion for summary judgment is denied. Defendant's motion for summary judgment is allowed, and the petition is dismissed.

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535 F. 2d 24

DAIRYLEA COOPERATIVE, INC. v. THE UNITED STATES

[No. 431–74. Decided May 12, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; interpretation; risk of loss.—In response to a June 16, 1972 announcement of the Commodity Credit Corporation (CCC), plaintiff offered to sell to CCC a quantity of butter stored in a CCC-approved warehouse. The contracting officer accepted the offer subject to the terms of the announcement by night letter dated June 19. On June 21, CCC consistent with the contract mailed to the warehouse copies of Form MP–269 with instructions to transfer title by in-store sale and execution of the form as a warehouse receipt; this material was not received until June 27 or 28. On June 23 the butter became contaminated by flood waters from Hurricane Agnes; it was subsequently condemned and destroyed. On June 30 the warehouseman was instructed by CCC not to execute the warehouse receipt. The contract was terminated for failure of

Opinion of the Court

plaintiff to deliver the butter in accordance with the provisions of the announcement. After denial of its claim for reimbursement of the contract price by the contracting officer and the Board of Contract Appeals, plaintiff filed the present suit. The issue is when did risk of loss pass, if at all. It is *held* that the contract was not ambiguous, the date of delivery being plainly fixed. The contract provided that title to the butter and risk of loss would pass to CCC upon delivery in-store; the date of delivery was to be on one of three dates, two of which were inapplicable; the third date was upon issuance of the warehouse receipt. Since the warehouse receipt was never executed, the risk of loss remained with plaintiff. The provision in the announcement that warehouse charges on the butter were paid through June 20, 1972 does not equate this date with the delivery date provisions since these provisions have separate and distinct functions. Plaintiff is not entitled to recover, its motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Contracts; sales; title, passing of; risk of loss.

[1] Where the terms of the contract required in-store delivery of the goods and provided that the date of delivery was to be the date of issuance of a warehouse receipt acceptable to defendant-buyer, risk of loss did not pass to defendant but remained with plaintiff-seller when, because of damage to the goods caused by hurricane flood waters, the receipt was not executed upon direction of defendant.

United States ⇐ 70(22)

John M. Freyer, attorney of record for plaintiff. *Bond, Schoeneck & King* and *James P. McDonald*, of counsel.

Marc J. Fink with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, SKELTON and KASHIWA, *Judges*.

SKELTON, *Judge*, delivered the opinion of the court:

This case involves the interpretation of a contract for the sale of butter. The plaintiff, Dairylea Cooperative, Inc. (Dairylea) is a farming cooperative in the business of manufacturing and selling commodities commercially and to the Government. In response to announcement LD-Da-3 of the Commodity Credit Corporation (CCC), "Purchase of Dairy Products," plaintiff offered to sell to the CCC some 214,151 pounds of grade AA butter in freezer space at the Hygeia

warehouse in Elmira, New York, on June 16, 1972. The offer stated that warehouse charges on the butter were paid through June 20, 1972. The contracting officer of the Minneapolis Commodity Office, by night letter dated June 19, 1972, accepted plaintiff's offer as follows:

> SUBJECT TERMS ANNOUNCEMENT LD–DA–3 CCC ACCEPTS YOUR BUTTER OFFER OF JUNE 16 1972 FOR 214,151 POUNDS AT 68.332 CENTS PER POUND. CONTRACT MP(FF)51465.

On June 21, 1972, copies one and two of the Notice to Deliver, Form MP–269, along with Form MP–277, Notice to Deliver and Transmittal and Instructions, were mailed to the plaintiff. Dairylea received this material at its offices in Syracuse, New York, two days later. Form MP–277 provided that for the transfer of title in-store, the vendor should "advise warehouseman of the total number of units and the applicable ex-lots for each grading certificate." The CCC also mailed on June 21, 1972, copies five, six, seven, and eight of Form MP–269A, Forwarding Notices, to the Hygeia warehouse in Elmira, New York. At the bottom of these copies of the form was a nonnegotiable warehouse or consignee receipt. The butter was contaminated by flood waters from Hurricane Agnes on June 23, 1972, before the warehouse ever received its copies of the Forwarding Notices. Hygeia did not receive this material until June 27 or 28, 1972. The butter was condemned by New York authorities and was destroyed.

The transfer of title to CCC was not executed, and on June 30, 1972, a representative of CCC visited the warehouse and instructed the warehouseman not to execute the transfer of title. Thereafter, CCC terminated the contract for failure to deliver the butter in accordance with the provisions of announcement LD–Da–3. Plaintiff appealed CCC's failure to pay for the butter to the contracting officer on August 21, 1972. The contracting officer concluded in his decision that CCC was not liable for the contract price of the butter because it was never delivered to CCC under the terms of the contract.

The plaintiff filed an appeal from the decision of the contracting officer with the Board of Contract Appeals of the Department of Agriculture (Board) by letter dated Septem-

ber 6, 1972, pursuant to the disputes clause of the Uniform Contractual Provisions (ASCS–101 Article 25), which was a part of the contract. A hearing was held before the Board on October 23, 1973, in which both parties participated and were represented by counsel. The Board's decision of August 16, 1974, denied Dairylea's appeal and claim for the contract price on the ground that the risk of loss had not passed to the CCC prior to June 23, 1972, the date on which the butter was contaminated.

The plaintiff filed suit in this court on December 16, 1974, alleging that the Board had improperly construed the provisions of the contract, especially the provisions pertaining to delivery and shifting of risk of loss. The plaintiff alleges further that the decision of the Board involves only a question of law involving the interpretation of the contract, and, therefore, is not entitled to finality under Section 2 of the Wunderlich Act (41 U.S.C. § 322 (1970)). The plaintiff seeks recovery of the contract price of $146,333.67 solely under Section 2 of that Act.

The case is before us on cross-motions for summary judgment.

The issue here presented is simply when did risk of loss pass, if at all. The contract provisions involved are as follows:

Announcement LD–Da–3

* * * * *

II. Submission of Offers

A. * * * Each offer must state:

* * * * *

5. If product is located in CCC-approved warehouse:

* * * * *

c. Date through which storage has been paid.

* * * * *

IV. Acceptance of Offers

Acceptance of offers will be by prepaid telegram filed within two business days following the day offer is received. The date of acceptance shall be the contract date.

V. Documents Constituting Contract

The offer, the acceptance, this Announcement and the "Uniform Contractual Provisions", Form

ASCS–101 (10–1–68), except Articles 5, 6, 7, 9, 11 (except 11 b is retained), 12, 16, 17, 19, 20, 30, 33, 34, and all Articles of Part IV, shall constitute the contract.

* * * * *

VIII. Location At Time of Sampling and Offer

* * * * *

B. *Butter.* Butter shall be located either in a CCC-approved warehouse for the storage of butter, Seller's manufacturing plant, or at an assembler's facility at the time of sampling and offering for sale to CCC. The butter shall remain in the location where sampled until delivered to CCC. Butter sampled and offered for sale which is in a CCC-approved warehouse may be in either cooler or freezer space.

* * * * *

XII. Delivery

The Minneapolis ASCS Commodity Office will issue a Notice to Deliver within seven business days after date of acceptance of offer. Seller shall deliver product as directed, within seven business days after receipt of instructions. Such delivery shall be directed by CCC in accordance with one of the following provisions:

A. *CCC-Approved Warehouse.*

* * * * *

2. If butter at the time it is offered for sale to CCC is in a warehouse approved by CCC for the storage of butter, it may be located either in cooler or freezer space, with delivery as follows:

* * * * *

b. If butter is offered for sale to CCC in freezer space, Seller will be required to make delivery (1) in-store in such freezer space with in-and-out handling charges and storage charges through date of delivery paid by the Seller, or (2) at CCC option F.O.B. cars or trucks, in which event Seller shall pay all necessary dunnage and bracing charges.

* * * * *

C. *Date of Delivery. The date of delivery shall be the date of shipment by carrier* (except as noted for dairy products transported by Seller's own truck or contract carrier), *date of issuance of warehouse*

receipt acceptable to CCC, or date of acknowledgement of receipt of the product by CCC, whichever is applicable.

Title to the product and risk of loss shall pass to CCC upon delivery. [Emphasis supplied.]

* * * * *

XIV. Storage Charges

For product delivered to CCC in a CCC-approved warehouse, (which in the case of butter must be in freezer space), Seller shall pay directly to the warehouseman all storage charges through the date of delivery to CCC, including in-and-out handling charges. Prepaid storage remaining on any lot at the time of delivery shall accrue to the benefit of CCC.

* * * * *

As shown above, Section XII C. of Announcement LD-Da-3 provides that the date of delivery shall be on one of three dates—date of shipment by carrier; date of issuance of a warehouse receipt acceptable to CCC; or date of acknowledgment of receipt of the product by CCC, "whichever is applicable." The same section provides further that "title to the product and risk of loss shall pass to CCC upon delivery." This provision of the contract between the parties is clear and unambiguous. Title was to be transferred in-store, so the issuance of the warehouse receipt was the applicable event for establishing the date of delivery. Contrary to the plaintiff's contention, the issuance of the receipt was more than a mere "ministerial" act. Obviously, the date of delivery could not be the date of shipment by carrier, for CCC was to take title in-store. Neither was the date of acknowledgment of the receipt of the product applicable, for no shipment was involved. Therefore, it must follow that the date of issuance of the warehouse receipt was to be the date of delivery. In very clear and precise terms, the parties agreed how the delivery date would be set and when risk of loss should pass to the buyer. We conclude that since the warehouse receipt was never issued, the risk of loss did not pass to CCC, but remained with Dairylea.

The contract was not ambiguous. The date of delivery was plainly fixed, as noted above. Delivery would occur only when Hygeia executed an acceptable warehouse receipt.

Plaintiff claims that Sections II A.5.c. and XII A.2.b. of the contract equate delivery with the date through which storage charges were paid by Dairlyea, namely June 20, 1972. These contract provisions have separate and distinct functions, other than date of delivery. Section XII A.2.b. was intended to give the CCC the option to decide, within seven days after acceptance of the plaintiff's offer, whether to take delivery in-store or to have the butter shipped elsewhere. The decision was to be made known to Dairylea and Hygeia by a Notice of Delivery sent to both of them by CCC. The section says nothing about how the date of delivery would be fixed, but only that the seller was required to pay storage charges through the delivery date, if delivery was to be taken in-store.

Section II A.5.c. was included for the purpose of enabling CCC to get the benefit of any prepaid storage charges paid by the seller. In the event that delivery took place before the date through which charges have been paid by the seller, CCC would receive a period of "free" storage. The date the warehouse receipt was executed would mark the beginning of CCC's liability for storage charges, assuming that prepaid storage charges did not go beyond that date. For example, if there had been no flood in Elmira on June 23 and Hygeia had executed the warehouse receipt on that date, it would have expected CCC to pay storage charges beginning June 23. Since Dairylea had paid for storage only until June 20, Hygeia could have recovered three days storage charges from Dairylea. These arrangements indicating how storage charges were to be paid do not render section XII C. as to date of delivery ambiguous.

Next, plaintiff contends that CCC had full control over the butter prior to the execution of the warehouse receipts, and that therefore section XII C. is rendered meaningless. We do not agree. In addition to the provisions of the contract and other facts, the testimony of Mr. Bullard, Manager of Dairylea, before the Board is significant. When asked if the butter was under Dairylea's control while it was in the warehouse, he answered unequivocally "yes."

The interpretation of the contract by the Board was correct. While we sympathize with Dairylea on having to bear

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the substantial loss of the butter due to an act of God (the storm), we see no legal way to shift the loss to the Government.

We hold that the butter was never delivered to the CCC by the execution of a warehouse receipt by Hygeia as required by the contract, and by reason thereof the risk of loss remained with Dairylea, the owner of the butter, and, consequently, Dairylea must bear the loss and is not entitled to recover the contract price of the butter from the Government in this case.

Plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, and plaintiff's petition is dismissed.

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536 F. 2d 347

WHITECLIFF, INC., d/b/a WHITE CLIFF MANOR v. THE UNITED STATES

[No. 407–74. Decided May 12, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; Medicare Act; Court of Claims jurisdiction to review provider reimbursement disputes; corrective adjustments.—Plaintiff, a provider of services under the Medicare Act, seeks a retroactive adjustment of its costs according to its work measurement study for the period 1967–1970 to correct alleged inadequate reimbursement. The request was denied by Blue Cross Association and Blue Cross of Northern Ohio, plaintiff's fiscal intermediaries, and on appeal and after a hearing by the Blue Cross Association Medicare Provider Appeals Committee in accordance with an established disputes procedure. Plaintiff contends that the Appeals Committee decision violated the Medicare statute. In declining to extend the reading of 42 U.S.C. § 405(h) precluding district court review of social security benefit decisions in *Weinberger* v. *Salfi*, 422 U.S. 749 (1975), except insofar as review is authorized elsewhere in the Social Security Act, to the present Medicare case for the years in question, the court concludes that such preclusion would prevent all review of large categories of cases and issues, including constitutional questions, and would accord absolute finality to adjudications by private organizations such as the Blue Cross fiscal intermediaries. Such a result would be of doubtful constitutional validity and would undermine the normal presumption in favor of judicial review. It is *held* that this court has jurisdiction to review the pro-

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vider reimbursement dispute at least for compliance with the governing statute. It is also *held* that the Appeals Committee violated the Medicare statute when it insisted upon treating plaintiff's work measurement study as an unrecognized method of cost apportionment. Plaintiff is entitled to a retroactive adjustment in its reimbursement, subject to any valid regulation limiting amount of retroactivity, if it can prove that its actual reasonable costs for 1967–1970 exceeded its reimbursement on the "combination" method. Otherwise, plaintiff's motion for summary judgment is denied, defendant's cross-motion is denied, and the case is remanded to the agency Secretary pursuant to Rule 149 and Pub. L. 92–415 for a hearing on plaintiff's reasonable costs and the adequacy of its reimbursements for said period, and for a retroactive corrective adjustment if appropriate. Proceedings are stayed for 6 months.

Court of Claims jurisdiction; public health and welfare; Medicare Act; review of provider reimbursement disputes.

[1] Where the Medicare statute provides for review, providers of services and courts must follow the specified procedures and limitations; in other cases a provider may obtain judicial review under a court's applicable general jurisdictional provisions, at least so far as to ensure compliance with statutory and constitutional provisions. In the Court of Claims 28 U.S.C. § 1491 is the pertinent jurisdictional provision both because of the provider's contract with the Government and because the Medicare legislation, fairly read, mandates appropriate payment to providers.

Courts ⟸ 449(1)
Social Security and Public Welfare ⟸ 241

Contracts; Medicare contract; cost determination; retroactive corrective adjustments.

[2] 42 U.S.C. § 1395x(v)(1)(B) providing for retroactive corrective adjustment of a provider's costs does not permit the agency Secretary to disregard the significant fact that his two approved methods of cost-determination can lead to inadequate reimbursement in certain circumstances and in particular cases. The Secretary cannot excuse his agency or his agents (here the fiscal intermediary) from the statutory duty to make retroactive adjustments by failing to promulgate the prescribed regulation or by using in its place regulations permitting only a prospective change of method and a retroactive adjustment to bring interim pyaments into agreement with the annual reimbursement produced by a method of determining costs. Thus, the subject Provider Appeals Committee in insisting upon treating plaintiff's work measurement study as an unrecognized method of cost apportionment and in finding no support in the law or regulations for the requested retroactive adjustment, regardless of the accuracy of the work measurement study, violated the Medicare statute.

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Phillip J. Campanella, for plaintiff; *Everett D. McCurdy*, attorney of record. *Speith, Bell, McCurdy & Newell* of counsel.

Julie P. Dubick, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, DAVIS and KASHIWA, *Judges*.

DAVIS, *Judge*, delivered the opinion of the court:

This controversy between a provider of services under the Medicare program and the Government presents primarily a dispute over 42 U.S.C. § 1395x(v)(1) (1970),[1] relating to the reimbursement to be made to a Medicare provider. Both parties have moved for summary judgment but we find that we cannot dispose of the case finally.

By contract accepted by the Government in 1966, plaintiff Whitecliff, Inc., operating an extended care facility, became a Medicare provider and thus entitled to reimbursement by the Government for reasonable costs incurred in giving services to Medicare beneficiaries. Whitecliff designated the Blue Cross Association (BCA) and Blue Cross of Northern Ohio (BCNO) as its fiscal intermediaries.[2]

In 1970 Whitecliff instituted a work measurement program which purportedly revealed that its actual Medicare costs for 1967–1970 exceeded the reimbursement received from the Government. Whitecliff submitted a request for a retroactive adjustment under 42 U.S.C. § 1395x(v)(1) to correct the alleged inadequate reimbursement. BCNO and BCA each denied the request, and Whitecliff appealed to the BCA Medicare Provider Appeals Committee, in accordance with a disputes procedure established by the BCA in 1968. After a hearing, the Appeals Committee upheld BCA's denial of the claim. Whitecliff then filed suit in this court for $213,755, the

[1] Statute citations are to the 1970 *Code* unless otherwise noted, because later amendments are inapplicable to this case. All section citations, standing alone, are to title 42 of the *Code*.

[2] A fiscal intermediary is a public agency or private organization which contracts with the Secretary of Health, Education, and Welfare, under 42 U.S.C. § 1395h(a), to determine the amount of reimbursement to be paid to providers and to make the payments. The contract may require the intermediary to perform additional services. *See* 42 U.S.C. §§ 1395h (a), (c).

amount of the alleged underpayment, asserting that it is entitled to a retroactive adjustment and that it was denied due process because the BCA Medicare Provider Appeals Committee was not an impartial decision-maker. The Government defends on the grounds, first, that the social security statute precludes any judicial review of the intermediaries' reimbursement determinations, and, second, that plaintiff's arguments have no merit.

A number of courts have considered the permissibility and scope of judicial review of Medicare provider reimbursement disputes. No consensus has emerged on whether courts may review the merits of reasonable cost determinations (*see, e.g., Schroeder Nursing Care, Inc.* v. *Mutual of Omaha Ins. Co.*, 311 F. Supp. 405, 408–09 (E.D. Wis. 1970) (court may not review amount determined to be reasonable cost); *Temple Univ.* v. *Associated Hosp. Serv.*, 361 F. Supp. 263, 267–70 (E.D. Pa. 1973) (court had jurisdiction to review merits of determination that a certain transfer of funds was restricted and therefore deductible from Medicare reimbursement); *Coral Gables Convalescent Home, Inc.* v. *Richardson*, 340 F. Supp. 646, 650 (S.D. Fla. 1972) (court could not make de novo reasonable cost determination, but court suggested that it might review for substantial evidence after an administrative hearing was held)), but the courts have uniformly sustained judicial review at least for compliance with the Constitution and the governing statute. *See, e.g., Aquavella* v. *Richardson*, 437 F. 2d 397, 400–02 (2d Cir. 1971); *Kingsbrook Jewish Medical Center* v. *Richardson*, 486 F. 2d 663, 666–68 (2d Cir. 1973); *Rothman* v. *Hospital Serv.*, 510 F. 2d 956, 958–60 (9th Cir. 1975); *Schroeder Nursing Care, Inc.* v. *Mutual of Omaha Ins. Co., supra* at 409; *Americana Nursing Centers, Inc.* v. *Weinberger*, 387 F. Supp. 1116, 1118–19 (S.D. Ill. 1975); *South Boston Gen. Hosp.* v. *Weinberger*, 397 F. Supp. 360 (W.D. Va. 1975). We accepted this scope of review in our order in *Goldstein* v. *United States*, 201 Ct. Cl. 888, *cert. denied*, 414 U.S. 974 (1973).

The Government contends, however, that the Supreme Court's recent decision in a social security benefits case, *Weinberger* v. *Salfi*, 422 U.S. 749 (1975), implicitly overruled these prior decisions and endorsed the Government's posi-

tion that there is no review at all of Medicare provider determinations such as the one now before us. In *Salfi* the Supreme Court ruled that 42 U.S.C. § 405(h) [3] precludes district court review of social security benefit decisions, except insofar as review is authorized elsewhere in the Social Security Act. *Id.* at 756–63. Because Section 1395ii of 42 *United States Code* makes Section 405(h) applicable to the Medicare program, the Government argues that Section 405(h), as interpreted in *Salfi*, prohibits judicial review of all Medicare determinations other than those few for which the act expressly provides review. For the years in question, the act explicitly treats judicial scrutiny of specified Medicare determinations only in 42 U.S.C. § 1395ff, which does not authorize review of the type of decision appealed by plaintiff.[4]

We decline the invitation to extend *Salfi's* reading of Section 405(h) to this Medicare case. The social security provisions with which the Supreme Court dealt in *Salfi* authorize appeals of all decisions made after hearings, without limitation as to issues; [5] the practical effect of the *Salfi* decision was simply the enforcement of the Section 405(g)

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[3] Section 405(h) states:

"The findings and decisions of the Secretary after a hearing shall be binding upon all individuals who were parties to such hearing. No findings of fact or decision of the Secretary shall be reviewed by any person, tribunal, or governmental agency except as herein provided. No action against the United States, the Secretary, or any officer or employe thereof shall be brought under section 41 of Title 28 [now the sections of Title 28 delimiting district court jurisdiction] to recover on any claim arising under this subchapter."

[4] 42 U.S.C. § 1395ff(c) entitles an institution to a hearing by the Secretary and to judicial review under Section 405(g) only after a decision to terminate the institution as a provider of services or a determination that the institution is not a provider of services. Other parts of 1395ff cover the rights of individual Medicare beneficiaries to hearings and appeals.

In 1972 and 1974, Congress enacted provisions and amendments greatly expanding statutory review of Medicare provider reimbursement determinations. An amendment of 1972 established a Provider Reimbursement Review Board with jurisdiction to review reimbursement disputes where the amount in controversy exceeds $10,000. Social Security Amendments of 1972, § 243, 86 Stat. 1420, 42 U.S.C. § 1395*oo*. In 1974 Congress enlarged the review provision of 1395*oo* to grant providers the right to obtain judicial review, in a district court, of any decision of the statutory Board and of any reversal, affirmance, or modification of the Board's decision by the Secretary. Pub. L. No. 93–484, § 3(a), 88 Stat. 1459 (1974), 42 U.S.C. § 1395*oo* (f)(1). These provisions apply only to cost reporting periods ending on or after June 30, 1973.

[5] Section 405(g) entitles any individual who was a party to a hearing to appeal any final decision made after a hearing. Because Section 405(b) entitles any individual prejudiced by an initial decision on an application for benefits to a hearing, the review secured by Section 405(g) potentially covers every benefits decision.

procedures and prerequisites to judicial review. *See also Mathews* v. *Eldridge*, 424 U.S. 319, 326–32 (1976). By contrast, the Medicare statute's express review provisions in effect prior to 1973 apply to extremely limited categories of cases involving providers.[6] To import into the Medicare program the *Salfi* preclusion of judicial review (except as expressly authorized) would be to prevent all review of very large categories of cases and issues, including constitutional questions, and to accord absolute finality to adjudications by private organizations like the BCA. Such a result would be of doubtful constitutional validity and would undermine the normal presumption in favor of judicial review.[7] We cannot assume that the Supreme Court would extend the *Salfi* interpretation of Section 405(h) to Medicare cases, where the consequences would be so dramatically different, and therefore we adhere to the pre-*Salfi* view of judicial review of Medicare provider disputes: Where the Medicare statute provides for review, providers and courts must follow the specified procedures and limitations; in other cases, a provider may obtain judicial review, under the general jurisdictional provisions which are applicable, at least so far as to ensure compliance with statutory and constitutional provisions.[8] In this court, 28 U.S.C. § 1491 (the Tucker Act) is the pertinent jurisdictional provision both because of plaintiff's contract with the Government and also because the Medicare legislation, fairly read, mandates appropriate payment to providers. *Cf. United States* v. *Testan*, 424 U.S. 392 (1976).

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[6] *See* note 4 *supra*.

[7] *See generally Johnson* v. *Robison*, 415 U.S. 361, 366–68, 373–74 (1974); *Barlow* v. *Collins*, 397 U.S. 159, 166–67 (1970); *Kingsbrook Jewish Medical Center* v. *Richardson*, 486 F. 2d 663, 667–68 (2d Cir. 1973); Homer & Platten, *Medicare Provider Reimbursement Disputes: An Analysis of the Administrative Hearing Procedures*, 63 GEO. L.J. 107, 126–29 (1974). In *Salfi* the Supreme Court distinguished *Johnson* v. *Robison*, *supra*, a case in which the Court held that a statute similar to 42 U.S.C. § 405(h) did not preclude review of the question raised, in part on the ground that review of a constitutional challenge to the statute would have been cut off if the interpretation contended for by the Government in *Johnson* had prevailed, while no constitutional challenges would be denied review under the Social Security Act. *See* 422 U.S. at 762.

[8] For disputes over reimbursements with respect to fiscal periods ending on or after June 30, 1973, Congress has largely resolved the problem of judicial review; only disputes where the amounts in controversy are less than $10,000 are left untreated by statute. *See* note 4 *supra*.

The standard of review set forth in *Goldstein*, *supra*, encompasses plaintiff's claim for money judgment, based as it is on an allegation that the BCA Medicare Provider Appeals Committee's decision violated the Medicare statute. Relying on 42 U.S.C. § 1395x(v)(1)(B) (1970), which states that the regulations "shall * * * provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive," plaintiff challenges the Committee's rejection of its attempt to use its work measurement study to prove that its Medicare reimbursements for 1967–1970 were inadequate. The Government's position is that it is immaterial that Whitecliff's work measurement study may show that its Medicare reimbursements for 1967–1970 were inadequate. The first leg of the argument is that, under Section 1395x(v)(1), the Secretary of Health, Education and Welfare is authorized to promulgate regulations setting forth the allowable methods for determining costs. The second leg is that the Secretary approved only two pertinent methods—the "departmental" and the "combination," 20 C.F.R. §§ 405.452(*a*), (*b*)[9]—but did authorize use of a "more sophisticated method" if the provider obtained prospective approval. 20 C.F.R. § 405.453(d)(2)(ii). The third leg is that plaintiff admittedly used the "combination" method and did not seek or obtain advance approval for any other method.[10] It follows, according to the Government, that plaintiff is precluded from any further reimbursement even though it can show that, for its circumstances, the "combination" method led to inadequate reimbursement; the failure to ask for and obtain advance approval of some better method of determining costs is enough to bar the provider.

The answer, we think, is that the statute's retroactivity provision—quoted above—does not permit the Secretary to

[9] These are methods for allocating or apportioning costs between Medicare patients and the provider's non-Medicare patients. Plaintiff's complaint is that the "combination" method it followed led in its case to inadequate allocation of costs to its Medicare patients. It is this difference for which Whitecliff is suing.

[10] *See* note 9 *supra*. Plaintiff's work measurement study did not utilize the "combination" or "departmental" methods.

disregard the significant fact that his two approved methods of cost-determination can lead to inadequate reimbursement in certain circumstances and in particular cases. That was the ruling in *Kingsbrook Jewish Medical Center* v. *Richardson*, 486 F. 2d 663 (2d Cir. 1973), in which the provider maintained, and the Government conceded, that the particular method there involved could result in inaccurate reimbursement in certain situations (including that plaintiff's). The Second Circuit held that the corrective adjustment mandated by 1395x(v)(1) applies wherever a cost method produces an inaccurate reimbursement and was "designed to rectify mistakes made by HEW in formulating a particular method of determining cost." 486 F. 2d at 669, 670. Obviously a regulation permitting a provider to seek a modified cost-method *for the future* is no substitute for the statutory requirement of "suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." [11] The Secretary cannot excuse his agency or his agents (here, the BCA) from the statutory duty to make such retroactive adjustments by failing to promulgate the prescribed regulation or by using in its place regulations permitting only a prospective change of method and a retroactive adjustment to bring interim payments into agreement with the annual reimbursement produced by a method of determining costs. *See Kingsbrook Jewish Medical Center* v. *Richardson*, *supra*, 486 F. 2d at 669–70.

The BCA Medicare Provider Appeals Committee therefore violated the Medicare statute when it insisted upon treating plaintiff's work measurement study as an unrecog-

[11] The Government contends that Section 1395x(v)(1) calls only for an annual adjustment, at year-end, when the total of the interim (monthly or more frequent) payments made under Section 1395g exceeds or falls below the reimbursement calculated on the basis of the cost report filed at year-end. The wording of the statute leaves no room for such an interpretation. It requires adjustment when the "reimbursement produced by the methods of determining costs" proves either inadequate or excessive. Under the regulations, the only reimbursement produced by the cost-determining methods is the reimbursement determined at the end of a fiscal period, after a provider has submitted its cost reports to which these methods are applied. The interim payments are merely monthly (or more frequent) estimates of costs, to which Section 1395x(v)(1) makes no reference. *See* 20 C.F.R. §§ 405.451–.454; *Kingsbrook Jewish Medical Center* v. *Richardson*, *supra*, 486 F. 2d at 669.

nized method of cost apportionment and found no support in the law or regulations for the requested retroactive adjustment, regardless of the accuracy of the work measurement study. The Committee should instead have determined whether Whitecliff had proved that its actual 1967–1970 Medicare costs (limited by reasonableness) exceeded the reimbursements it received under the "combination" method of determining costs and have granted a retroactive adjustment if Whitecliff had proved its claim that that method was inadequate for Whitecliff's situation. Because the Committee made no findings on Whitecliff's actual costs for 1967–1970, no comparison of those costs with its reimbursements for those years, and no evaluation of the accuracy of the method under which the provider was paid, we must remand to the Secretary for a hearing at which Whitecliff will be given an opportunity to prove its actual costs and the inadequacy of its reimbursement.[12]

We need not and do not decide plaintiff's remaining contention that the composition of the BCA Appeals Committee violated due process in that three of the five members were BCA employees. However, we note that one district court has found this issue to be substantial and another has ruled that the BCA Committee's composition does deprive a provider of the impartial decision-maker required by cases such as *Goldberg* v. *Kelly*, 397 U.S. 254, 271 (1970). *See Temple Univ.* v. *Associated Hosp. Serv.*, 361 F. Supp. 263, 267 (E.D. Pa. 1973); *St. Louis Univ.* v. *Blue Cross Hosp. Serv., Inc.*, 393 F. Supp. 367, 371 (E.D. Mo. 1975); *Faith Hosp. Serv.* v. *Blue Cross Hosp. Serv., Inc.*, 393 F. Supp. 601, 602 (E.D. Mo. 1975).[13] *See also* Homer & Platten, *supra* note 7, at 131–33. *But see Community Hosp. of Indianapolis, Inc.* v. *Blue Cross Ass'n*, No. IP 73–C–615 (S.D. Ind. Dec. 18, 1974) (com-

[12] 42 U.S.C. § 405(h) seems to us to indicate that federal courts do not have jurisdiction to try and determine in the first instance a provider's reasonable costs. *See* note 3 *supra*.

[13] In decisions issued after this opinion was prepared and adopted, the Eighth Circuit modified the Eastern District of Missouri's decisions in *St. Louis University* and *Faith Hospital*. The Circuit court found, contrary to the district court, that the composition of the Committee is constitutionally permissible but agreed that due process precludes vesting the final determination of the issues in the Committee as constituted. Therefore, the court merely modified the district court's judgment, retaining the requirement that the Secretary make the final determinations. *St. Louis Univ.* v. *Blue Cross Hosp. Serv.*, Nos. 75–1274 & 75–1293 (8th Cir. Apr. 12, 1976); *Faith Hosp. Ass'n* v. *Blue Cross Hosp. Serv.*, Nos. 75–1301 & 75–1344 (8th Cir. Apr. 12, 1976).

position of Committee does not violate due process). The Secretary could obviate any due process challenge to the decision on remand by providing plaintiff with a hearing before a body not composed in its majority of BCA employees.

In conclusion, we hold that the plaintiff is entitled to a retroactive adjustment [14] in its reimbursement if it can prove that its actual reasonable costs for 1967–1970 exceeded its reimbursement on the "combination" method, but otherwise deny plaintiff's motion for summary judgment, deny the Government's cross-motion, and remand the case to the Secretary of Health, Education, and Welfare pursuant to Rule 149 and our remand statute, Pub. L. No. 92–415, 86 Stat. 652 (1972), 28 U.S.C. § 1491 (Supp. IV, 1974), for a hearing on plaintiff's reasonable costs and the adequacy of its reimbursements for the years 1967–1970, and for a retroactive corrective adjustment [15] if plaintiff proves that its reimbursements were inadequate. Further proceedings in this court are stayed for a period of six (6) months from the date of this decision. Plaintiff's counsel is designated to advise the court by letter, at intervals of 90 days, of the status of the remand proceedings. The parties and the Secretary should also take note of Rule 150.

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535 F. 2d 27

CUSHING STONE COMPANY, INC. v. THE UNITED STATES

[No. 419–70. Decided May 12, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; income tax; deductions; mine development expenses.—This case is before the court on a stipulation of facts. Since 1917, plaintiff has operated a limestone quarry on lands it either owned in fee or to which it had quarrying rights. Prior to 1963, plaintiff's quarry was bisected by a narrow strip of land owned by Niagara Mohawk Power Corp. and containing the latter's power transmission towers and lines. Plaintiff's quarrying operations initially were confined to an area west of the utility strip. Plaintiff had the right to cross the strip, however, by tunnneling or other acceptable means to gain access to the eastern portion of its quarry land. By 1962,

[14] Subject to any valid regulation, applicable to this case, which may limit the amount of retroactivity of corrective adjustments under § 1395x(v)(1). *See Kingsbrook Jewish Medical Center* v. *Richardson, supra,* 486 F. 2d at 670.
[15] *See* note 14, *supra.*

Syllabus

plaintiff's quarriable stone supply in the western portion was nearly exhausted, and since development of the quarry to the north and south was economically or physically impossible, orderly mining could continue only if plaintiff gained access to its lands to the east of the strip. However, since tunneling under the strip or developing a new eastern quarry face were prohibitively expensive, plaintiff entered into two agreements with Niagara whereby plaintiff agreed to exchange certain land for the strip and to bear the full cost of costs of removing and relocating the towers and lines. In order to obtain property to exchange for the strip, plaintiff purchased tracts of land from third parties at a cost of $34,174, and in April 1963 conveyed to Niagara 23+ acres upon which the latter's transmission towers and lines were to be relocated (the said acreage consisting of the purchased tracts as well as land previously owned by plaintiff). Niagara then conveyed to plaintiff 31+ acres, including most of the utility strip and 11+ acres to which plaintiff already had quarrying rights. As a result of the exchange and relocations, plaintiff gained access by the most economical means to 11+ million tons of accessible and quarriable stone. The cost of the removal and relocation of Niagara's transmission towers and lines was $166,614. On its 1965 Federal tax return plaintiff deducted the full $200,788 (i.e., the $166,614 and the $34,174) as mine development expenditures under Sec. 616(a) of the Internal Revenue Code. This deduction, however, was disallowed on the ground that it was a nondeductible capital outlay within the meaning of Sec. 263 of the Code. Plaintiff then paid an additional $42,725 in taxes and interest, and upon denial of its claim for refund filed the present suit. At oral argument plaintiff indicated a willingness to charge the $34,174 item to a capital account. Accordingly, the court need only consider the deductibility of the $166,614, expended to remove the transmission towers and lines. Since under the stipulated facts the latter expenditure was incurred after commercially marketable quantities of stone had been disclosed, the only issue before the court is whether the expenditure was "for the development of a mine or other natural deposit." Defendant contends that plaintiff lost the deduction it might otherwise have been entitled to when it altered the manner in which it gained access, i.e. by removing and relocating the towers and lines rather than by tunneling under the strip; that the $166,614 was not directly attributable to some physical activity but was merely a part of the consideration plaintiff paid for the strip; that *Kennecott Copper Corp.* v. *United States*, 171 Ct. Cl. 580, 347 F. 2d 275 (1965), was wrongly decided and should not be followed, and that later decisions of other courts require this court to overrule its holding in *Kennecott* that the costs of acquiring access to areas in which to conduct developmental activities are part of the development costs of a producing mine. It is *held* that the basic holding of *Kennecott* is correct and disposes of defendant's contention that the $166,614 expenditure is nondeductible. It is also *held*, on the basis of the stipulated facts,

Syllabus

that the costs incurred under the removal and relocation agreement were *not* a part of the consideration plaintiff paid for the strip. The mere fact that the two agreements are component parts of a single plan does not mean that the agreements are so inextricably bound together that the costs incurred under the separate removal and relocation agreement are simply a part of the consideration plaintiff paid for the strip. Plaintiff is entitled to deduct the $166,614 as a mine development expenditure under Sec. 616(a). Plaintiff's motion for summary judgment is granted to that extent and defendant's cross-motion is denied. Plaintiff's expenditure of $34,174 was a capital cost, and accordingly with respect to this item plaintiff's motion for summary judgment is denied and defendant's cross-motion is granted. The case is remained to the trial judge to determine the amount of plaintiff's recovery.

Taxes; income tax; deductions; expenses; mine development expenditures.

[1] In determining the deductibility of an expenditure under 26 U.S.C. § 616(a) of the Internal Revenue Code of 1954, which provides a deduction from taxable income for all expenditures incurred "for the development of a mine or other natural deposit," it is quite proper to attach some weight to the taxpayer's underlying purpose for making a contested expenditure (particularly where that purpose is unambiguous and fully supported by the evidentiary record).

Internal Revenue ⇐ 567

Taxes; income tax; deductions; expenses; mine development expenditures.

[2] Absent a clear indication from Congress that under Sec. 616(a) only expenditures relating to a physical mining "activity" are deductible as mine development expenditures, the court does not accept the restrictive view of the Tax Court and the Sixth Circuit in *Geoghegan & Mathis, Inc.* v. *Commissioner*, 55 T.C. 672 (1971), *aff'd* 453 F. 2d 1324, *cert. denied*, 409 U.S. 842 (1972). Both courts failed to adequately distinguish between expenditures to acquire access rights at a time a mine is commencing production and similar expenditures incurred, for entirely different reasons, during the production stage of the mine. The term "development" expenditures is sufficiently flexible to cover the necessary costs of acquiring access, *during the producing stage* of a mine, to areas in which to conduct additional development activities.

Internal Revenue ⇐ 567

Taxes; income tax; deductions; expenses; mine development expenditures.

[3] Where plaintiff, in an effort to gain access in the most economical manner to its lands to the east of a utility strip bisecting plaintiff's quarry, agreed, inter alia, to bear the cost of removing and relocating transmission towers and lines located thereon, the costs

Opinion of the Court

incurred under the agreement are fully deductible under 26 U.S.C. § 616(a) as mine development expenditures. Such costs do not differ in any material way from other deductible mine development expenditures, such as tunneling, stripping or removal of overburden, that are "necessary to make the ore or other mineral accessible."

Internal Revenue ⇐ 567

C. J. Head, attorney of record, for plaintiff. *Hays, Landsman & Head*, of counsel.

Gilbert W. Rubloff, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Donald H. Olson*, of counsel.

William D. Crampton, for the National Coal Association, amicus curiae. *Robert F. Stauffer*, of counsel.

Before COWEN, *Chief Judge*, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges*, *en banc*.

COWEN, *Chief Judge*, delivered the opinion of the court:

This case, before the court on the parties' respective motions for summary judgment, requires us to determine whether certain expenditures incurred by a quarry operator for the removal and relocation of power transmission towers and lines located on a utility strip traversing the quarry property are "development" expenditures within the meaning of Section 616(a) of the Internal Revenue Code of 1954.

I

The material facts are stipulated. Since 1917, plaintiff, Cushing Stone Company, Inc., has operated an open pit dolomite limestone quarry in Montgomery County, New York, on lands which plaintiff either owned in fee (148 acres) or to which it possessed stone quarrying rights (20.46 acres). Prior to 1963, these lands were separated by a 300-foot-wide strip of land owned by Niagara Mohawk Power Corporation (Niagara Mohawk) and on which Niagara Mohawk had erected transmission towers and lines.[1] Although

[1] The 20.46 acres on which plaintiff held stone quarrying rights also were owned by Niagara Mohawk. Of the 20.46 acres, 12.06 acres abutted the east side of the utility strip and 8.40 acres abutted the west side. Plaintiff had acquired quarrying rights in this acreage from Niagara Mohawk's predecessor, New York Power and Light Corporation, by deed dated March 11, 1930.

plaintiff had no stone quarrying rights in the utility strip, it did have the right to cross the strip by tunnel or other acceptable means in order to gain access to the remainder of its quarry lands.[2]

Plaintiff's quarrying activities initially were confined to an area west of Niagara Mohawk's utility strip. By 1962, however, plaintiff's operations had progressed to the point where the open face of its quarry abutted the western edge of the utility strip. According to plaintiff's estimates, the supply of quarriable stone in the lands to the west of the strip would be completely exhausted within 5 years. Since further development of the quarry to the north and south was economically or physically impossible, orderly mining could continue only if plaintiff gained access to its land to the east of the utility strip.

The necessary access clearly could have been gained by tunneling under the transmission lines or developing a new quarry face on the eastern side of the strip. However, since both alternatives were prohibitively expensive and would have rendered its operations uneconomical and uncompetitive, plaintiff concluded that Niagara Mohawk's transmission lines and towers would have to be removed and relocated on other lands.[3]

On September 19, 1962, after several years of negotiations, plaintiff and Niagara Mohawk entered into two separate agreements pursuant to which plaintiff agreed to exchange certain land for the utility strip and to bear the full cost of removing and relocating the transmission towers and lines. Plaintiff then purchased 22 acres of land from Edward W. Miller and 46.7 acres of land from Charles D. Persons, Jr., at an aggregate cost of $34,174. Although the principal purpose of these acquisitions was to obtain property to exchange for the utility strip, plaintiff recognized

[2] Plaintiff had acquired this right in 1930 when it purchased stone quarrying rights in the 20.46 acres of Niagara Mohawk land abutting the utility strip.

[3] Plaintiff had begun planning for the eventual relocation of Niagara Mohawk's transmission facilities as early as October 1954, when the company's Board of Director's established a reserve fund of $250,000 "for the express purpose of providing funds from which to pay the necessary cost of moving and relocating high-tension lines and towers of the Niagara Mohawk Power Corporation which cross the property of this company at its Cranesville Quarry." At a meeting held November 9, 1960, this reserve was increased to $350,000.

that certain portions of the Miller and Persons tracts would be retained by plaintiff and mined to the extent that they contained exploitable quantities of stone.[4]

On April 12, 1963, plaintiff conveyed to Niagara Mohawk a strip of approximately 23.67 acres of land, upon which the latter's transmission lines were to be relocated.[5] This acreage consisted of part of the tracts acquired from Miller and Persons, as well as land previously owned by plaintiff. Ten days later, Niagara Mohawk conveyed to plaintiff in fee approximately 31.45 acres of land, including virtually all of the utility strip and approximately 11.29 acres of land to which plaintiff already had stone quarrying rights.[6]

As a result of the exchange of land and the ultimate relocation of Niagara Mohawk's transmission towers and lines, plaintiff gained access by the most economical means to 11.08 million tons of accessible and quarriable stone.[7] Of this amount, 4.28 million tons are contained in lands which plaintiff previously owned or to which it had quarrying rights, but to which access had been effectively blocked by Niagara Mohawk's transmission towers and lines. The remaining 6.80 million tons represent the net gain to plaintiff from the exchange of lands with Niagara Mohawk (1.94 million tons)[8] and plaintiff's retention of a portion of the Persons tract (4.86 million tons).

Niagara Mohawk eventually expended $166,614 in physically removing and relocating the transmission towers and

[4] In order to obtain the lands it needed to make the exchange with Niagara Mohawk, plaintiff had to acquire the Miller and Persons tracts in their entirety. Of the acreage eventually retained by plaintiff, only the Persons tract contained accessible quantities of quarriable stone (approximately 4.86 million tons).

[5] In addition to the 23.67 acres, plaintiff also relinquished its stone quarrying rights in approximately 5.29 acres of land already owned by Niagara Mohawk.

[6] Of the 11.29 acres, 8.23 acres had been mined and virtually depleted of quarriable stone by the time plaintiff acquired the fee title. The remaining 3.06 acres were inaccessible for future quarrying operations.

[7] All estimates of the tonnage of quarriable stone acquired and relinquished by plaintiff in connection with the relocation of the transmission towers and lines were made solely for purposes of this litigation. No estimates were made before, contemporaneous with or in anticipation of the acquisitions and exchanges at issue.

[8] The 31.45 acres acquired by plaintiff in the exchange are estimated to contain approximately 7.82 million tons of quarriable stone. Since the 23.67 acres conveyed by plaintiff to Niagara Mohawk only contain an estimated 5.88 million tons of quarriable stone, plaintiff's net gain is approximately 1.94 million tons of stone.

lines. Plaintiff was billed for this amount, which it paid on February 23, 1965. The costs of acquiring the Miller and Persons tracts (i.e., $34,174), which originally had been entered on a capital account, were then transferred to an expense account and treated as a part of plaintiff's overall cost of relocating the transmission towers and lines. The full $200,788 (i.e., the $166,614 and the $34,174) was deducted on plaintiff's 1965 tax return as a mine development expenditure.[9]

When the Internal Revenue Service (IRS) audited plaintiff's 1965 return, it disallowed the claimed deduction on the ground that the $200,788 was a nondeductible capital outlay within the meaning of section 263 of the Code. Plaintiff was then assessed an additional $42,725 in taxes and interest. After paying the IRS the full amount of the assessment, plaintiff filed a timely claim for refund, which was denied.[10] This action ensued.

Plaintiff originally claimed in its petition that both the $166,614, expended to remove and relocate the transmission towers and lines, and the $34,174, expended to acquire the Miller and Persons tracts, were fully deductible as mine development expenditures under section 616(a). At oral argument, however, plaintiff informed the court that it was willing to charge the entire $34,174, including any part thereof which might be deductible, to a capital account. As a result of this concession, we need only consider the deductibility of the $166,614.

II

Section 616(a) provides a current deduction from taxable income for

> all expenditures paid or incurred during the taxable year for the development of a mine or other natural deposit (other than an oil or gas well) if paid or incurred after

[9] As a result of this deduction, plaintiff realized a net operating loss in 1965 of $68,402.

[10] In addition to the refund claim for $42,725, plaintiff also filed a separate claim for refund in the amount of $30,143, with interest, based upon the carryback to 1962 of plaintiff's 1965 net operating loss. This claim, which was disallowed on the ground that plaintiff's 1965 net operating loss had been eliminated by the disallowance of the $200,788 deduction, is also at issue in this proceeding.

the existence of ores or minerals in commercially marketable quantities has been disclosed.[11]

Since it is undisputed that plaintiff's $166,614 expenditure was incurred after commercially marketable quantities of limestone had been disclosed, the only issue we must decide is whether that expenditure was "for the development of a mine or other natural deposit."

Neither section 616(a) nor the regulations promulgated thereunder articulate a standard for determining when an expenditure is for the development of a mine. The Senate Finance Committee, in its report accompanying the enactment of the predecessor to section 616(a), merely indicated that such expenditures *include* "the costs of shafts, tunnels, galleries, etc., *which are necessary to make the ore or other mineral accessible.*" S. Rep. No. 781, 82d Cong., 1st Sess. 43 (1951) (emphasis added). The IRS has adopted the view that an expenditure is not deductible as a development expenditure unless it was incurred as the direct result of some physical mining process or activity, such as removing overburden, stripping, laying pipe, sinking shafts, or tunneling, which is necessary to make the ore or minerals in place accessible for production operations.[12]

If plaintiff had exercised its right to tunnel under Niagara Mohawk's utility strip,[13] it is clear that plaintiff could have

[11] Int. Rev. Code of 1954, § 616(a). Section 616(a) is derived, with only minor clerical changes, from section 23(cc) of the 1939 Code, which had been enacted in 1951 by section 309(a) of the Revenue Revision Act of 1951, ch. 521, § 309(a), 65 Stat. 486. Prior to 1951, virtually all expenditures incurred before a mine had reached the production stage, had to be charged to a capital account and recovered through the depletion allowance. Treas. Reg. 111, § 29.23(m)–15(a); *see* G.C.M. 13954, XIII–2 Cum. Bul. 66, 69 (1934). After the mine had reached the production stage, however, all ordinary development expenditures required to maintain normal production were deductible as operating costs in the year paid or incurred. *United States Gypsum Co.* v. *United States*, 206 F. Supp. 744, 749 (N.D. Ill. 1962). Extraordinary or "capitalized" development expenditures, incurred during the production stage, were treated as deferred operating expenses deductible ratably as the ores or minerals benefited thereby were produced and sold. G.C.M. 13954, *supra*, at 72. *See generally* 4 J. Mertens, *The Law of Federal Income Taxation* § 24.54, at 326–27 (rev. ed. 1973); Alexander & Grant, *Mine Development and Exploration Expenditures*, 8 Tax L. Rev. 401, 403 (1953); Grossman & Johnson, *Distinction Between Exploration and Development Expenditures in the Hard Minerals Industry*, 27 Tax Lawyer 119, 120 (1973).

[12] Rev. Rul. 67–169, 1967–1 Cum. Bul. 159, 160; Rev. Rul. 67–35, 1967–1 Cum. Bul. 159; Rev. Rul. 66–170, 1966–1 Cum. Bul. 159, 160.

[13] *See* note 2 *supra*.

deducted its tunneling expenditures under section 616(a) without challenge from the IRS. Since tunneling, however, would have cost as much as $500,000, plaintiff chose to accomplish the same result, at considerably less expense, by removing and relocating Niagara Mohawk's transmission towers and lines. Defendant, however, contends that plaintiff lost the deduction that it otherwise would have been entitled to when it altered the manner in which it gained access, i.e., by removing and relocating the transmission towers and lines rather than by tunneling under them. We cannot agree. In our opinion, the Government's position is economically wasteful and would inject into section 616(a) a rigidity that conflicts in spirit and substance with Congress' intent in providing for the deductibility of mine development expenditures.

Defendant's theory for denying plaintiff the deduction it seeks is that the $166,614 is not directly attributable to some physical activity, but is merely a part of the consideration that plaintiff paid for the utility strip. Even assuming the validity of defendant's characterization of plaintiff's expenditure, it is clear that our main holding in *Kennecott Copper Corp.* v. *United States*, 171 Ct. Cl. 580, 347 F. 2d 275 (1965), disposes adversely of defendant's argument. Defendant, however, contends that *Kennecott* was wrongly decided and should not be followed.

The majority of defendant's attacks on *Kennecott* are arguments, bolstered by the same case support, that were fully considered and rejected in that decision. To the extent that defendant has added no new support to those arguments, they need not be reconsidered for purposes of this opinion. Defendant, however, has also advanced arguments based wholly or in part on cases decided after *Kennecott*. Defendant maintains that these cases compel us to overrule our holding in *Kennecott* that the costs of acquiring access to areas in which to conduct developmental activities, such as stripping, dumping, and leaching, are part of the development costs of a producing mine. While we conclude, in Part III of this opinion, that the basic holding of *Kennecott* is correct and disposes of defendant's contention that plaintiff's $166,614 expenditure is nondeductible, we think it is also clear that

defendant's characterization of that expenditure as purely a land acquisition cost is inaccurate. The stipulated facts reveal quite the contrary—that the expenditure was incurred to remove and relocate a physical obstruction that prevented plaintiff from gaining access in the most economical means to quarry lands that it already owned. In Part IV of the opinion, we discuss this aspect of the case and conclude, independent of *Kennecott*, that plaintiff's $166,614 expenditure is fully deductible and does not differ in any material way from other deductible developmental expenditures, such as tunneling, stripping, or the removal of overburden, that are "necessary to make the ore or other mineral accessible." *See* S. Rep. No. 781, 82d Cong., 1st Sess. 43 (1951).

III

In urging that *Kennecott* was wrongly decided and should not be followed,[14] defendant argues that the court erred (1) in relying upon Kennecott's primary purpose for making the contested expenditures, and (2) in rejecting the Government's argument that only expenditures directly related to some physical mining process or activity are deductible as mine development expenditures. We address these issues seriatim.

A

The court in *Kennecott* relied on the taxpayer's primary purpose in determining whether the expenditures at issue were deductible (1) as "ordinary and necessary" expenses of mining,[15] and (2) as mine development costs under section 23(cc) of the 1939 Code.[16] In requesting that we reconsider our holding in *Kennecott*, defendant contends that reliance upon the taxpayer's primary purpose has been effectively foreclosed in "this type of situation" by the Su-

[14] *See* Rev. Rul. 67–35, 1967–1 Cum. Bul. 159 (Commissioner's nonacquiescence in *Kennecott*). *See also* Rev. Rul. 66–170, 1966–1 Cum. Bul. 159 (costs incurred by quarry operator to reimburse power company for the relocation of transmission facilities located on right-of-way through quarry property are additional capital expenditures for the acquisition of rights to the mineral property and are not development expenditures under section 616(a)).

[15] *See* 171 Ct. Cl. at 629–31, 347 F. 2d at 304–05.

[16] *See id.* at 643, 347 F. 2d at 312.

preme Court's opinion in *Woodward* v. *Commissioner*, 397 U.S. 572 (1970).[17]

In *Woodward*, the taxpayers, majority stockholders of an Iowa corporation, had voted in favor of a perpetual extension of the corporation's finite charter. Under Iowa law, the stockholders voting for the extension were required to "purchase at its real value the stock voted against such renewal." 397 U.S. at 573. After attempts to reach an agreement with the single dissenting shareholder on the "real value" of his minority interest had failed, the taxpayers brought an appraisal action in state court. That court determined the value of the dissenting shares and taxpayers purchased the minority interest at the price fixed by the court. Taxpayers then claimed as tax deductions various legal, accounting, and appraisal fees incurred in connection with the appraisal litigation, on the ground that they were "ordinary and necessary expenses paid * * * for the management, conservation, or maintenance of property held for the production of income." 397 U.S. at 574. The IRS, however, characterized the fees as capital expenditures "incurred in connection with the acquisition of capital stock of a corporation," and denied the deductions. *Id.*

In the ensuing litigation, the taxpayers argued that the proper standard for determining whether the expenditures were to be considered as incurred in the acquisition of a capital asset was the "primary" purpose test.[18] The Supreme Court, however, found that, while such a test was proper in other circumstances, the better test in cases involving the deductibility of appraisal litigation fees was one that involved "the simpler inquiry whether the origin of the claim litigated

[17] Plaintiff in the instant case does not seek to deduct its $166,614 expenditure as an "ordinary and necessary" expense of mining. As a result, the court need only consider defendant's argument as it pertains to reliance upon the taxpayer's purpose in determining the deductibility of mine development expenditures under section 616(a).

[18] The "primary" purpose test urged by the taxpayers had been developed in cases involving the deductibility of costs incurred in "defending or perfecting title to property." 397 U.S. at 576–77; *see* Treas. Reg. § 1.263(a)–2(c). The taxpayers' argument that the test should also be applied to costs incurred in appraisal litigation had been rejected by the Eighth Circuit in *Woodward*, 410 F. 2d 313 (8th Cir. 1969), but accepted by the Seventh Circuit in *Hilton Hotels Corp.* v. *United States*, 410 F. 2d 194 (7th Cir. 1969), *rev'd*, 397 U.S. 580 (1970). The Supreme Court had granted certiorari to resolve that split. 397 U.S. at 574.

is in the process of acquisition itself." 397 U.S. at 577. Applying that standard, the Court held that, since the origin of the appraisal litigation was the purchase, required by law, of the stock of the dissenting shareholder, "the expenses incurred in that litigation were properly treated as part of the cost of the stock that the taxpayers acquired." *Id.* at 579.

Defendant construes *Woodward* as precluding any and all reliance on the taxpayer's purpose in determining whether an expenditure is deductible as a mine development expenditure under section 616(a). Defendant concedes, however, that the *Woodward* case, involving the deductibility or capitalization of appraisal litigation expenses, is factually distinguishable from the instant case. We need only go one step further, and add that the case is so readily distinguishable that it has no pertinence to the issue before us.

The deductibility of the expenditures at issue in this case turns on the application of a special section of the Code providing a deduction from taxable income for all expenditures incurred "*for the development of a mine or other natural deposit.*" Int. Rev. Code of 1954, § 616(a) (emphasis added). In making that determination, we consider it quite proper to attach some weight to the taxpayer's underlying purpose for making the contested expenditure (particularly where that purpose is unambiguous and fully supported by the evidentiary record).[19]

Defendant's suggestion that under *Kennecott* a miner might be able to deduct the cost of acquiring additional minerals greatly exaggerates our holding in that case. Although the taxpayer in *Kennecott* did acquire certain rights in disseminated copper ore, those rights were found to be

[19] *See Santa Fe R.R. Co.* v. *United States*, 254 F. Supp. 455, 460 (N.D. Ill. 1965), *aff'd*, 378 F. 2d 72 (7th Cir. 1967) (expenditure deductible as exploration expenditure because taxpayer's primary purpose in tunneling and trenching was to search for and locate ore); *Estate of DeBie* v. *Commissioner*, 56 T.C. 876, 893–94 (1971) (expenditure made for purpose of further delineating the location and extent of known commercial ore body is development expenditure). *See generally Grossman & Johnson, supra* note 11 (determination of whether expenditure is deductible as development or exploration expenditure requires an examination of the underlying purpose of the expenditure). *But see Geoghegan & Mathis, Inc.* v. *Commissioner*, 55 T.C. 672, 676 (1971), *aff'd*, 453 F. 2d 1324 (6th Cir.), *cert. denied*, 409 U.S. 842 (1972) (criticizing this court's reliance in *Kennecott* on the taxpayer's primary purpose).

incidental to the other, more important rights that were acquired. 171 Ct. Cl. at 591, 596–98, 610, 347 F. 2d at 280–81, 284–85, 292. Despite the Government's arguments to the contrary, the court held, on the specific facts of the case, that the presence of an incidental nondeductible benefit in a bundle of deductible rights should not adversely affect the basic deductibility of the expenditures incurred. *Id.* at 598, 347 F. 2d at 285. As the court put it

> It is not the spirit of the law that the presence, wholly as an incident, of a nondeductible benefit among a bundle of rights acquired for a purpose which makes the bundle as a whole deductible, should infect all of the parts like a spoiled apple in the bottom of the barrel. Instead, the presence of such a benefit in a bundle of rights is a relative thing, and should be evaluated as such. It is concluded therefore, that if, in fact, plaintiff's purpose in making the substitute facilities expenditures was such as to render those expenditures deductible as mining expenses, the failure to allocate costs to the copper content of Tract A should not preclude recovery. [*Id.*]

That statement, however, in no way sanctions the deductibility of nonincidental mineral acquisitions. In an appropriate case, the court would be justified in allocating a portion of the expenditures for which a deduction is sought to any significant nondeductible benefit realized by the taxpayer. In *Kennecott*, the court concluded, solely on the basis of the facts before it, that an allocation was not required. In this case, were it not for plaintiff's concession at oral argument, we would treat some portion of the $34,174 that plaintiff expended for the Miller and Persons tracts as a capital expenditure.[20] However, plaintiff's concession makes an allocation unnecessary.

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[20] Plaintiff had acquired the Miller and Persons tracts for the purpose of obtaining land to exchange with Niagara Mohawk for the latter's utility strip. However, in order to acquire any of the land owned by Miller and Persons, plaintiff had to agree to acquire all of their property. The excess acreage which plaintiff acquired, and eventually retained, contains approximately 4.86 million tons of quarriable stone. Defendant urges us to make an allocation that would take into account this nondeductible benefit, and the fact that plaintiff realized a net gain of approximately 1.94 million tons of stone in the exchange of lands with Niagara Mohawk. Plaintiff's agreement, however, to treat the entire cost of the Miller and Persons tracts as a nondeductible capital expenditure makes it unnecessary for us to embark on such an undertaking.

B

In both the *Kennecott* case, and its nonacquiescence therein, the IRS took the position that only expenditures directly attributable to a physical mining activity, such as tunneling, stripping, or shaft-sinking, are deductible as mine development expenditures. That argument was rejected in *Kennecott*, the court finding that the costs of acquiring access through easements to areas in which to carry on developmental activities were a legitimate part of the development costs of a producing mine. *See* 171 Ct. Cl. at 634–35, 643, 347 F. 2d at 307–08, 312. Subsequent to our decision in *Kennecott*, the Government successfully urged its theory upon the Tax Court and the Sixth Circuit in *Geoghegan & Mathis, Inc.* v. *Commissioner*, 55 T.C. 672 (1971), *aff'd*, 453 F. 2d 1324 (6th Cir.), *cert. denied*, 409 U.S. 842 (1972).[21] Encouraged by its success in that case, defendant has tried to persuade us to overrule *Kennecott* and to adopt the view that only costs directly attributable to a physical mining activity are deductible under section 616(a).

In support of its position, defendant relies on two cases, in addition to *Geoghegan & Mathis*, that were decided after *Kennecott*. *See Santa Fe R.R. Co.* v. *United States*, 378 F. 2d 72 (7th Cir. 1967); *Amherst Coal Co.* v. *United States*, 295 F. Supp. 421 (S.D. W.Va. 1969), *aff'd per curiam*, 27 P–H Am. Fed. Tax Rep. ¶ 71–358 (4th Cir. 1971). We think that neither of these cases stands for the broad proposition urged by the defendant.

The taxpayer in *Santa Fe* had instituted a detailed investigative program designed to obtain information concerning the nature, quality, and extent of uranium-bearing ore in

[21] The taxpayer in *Geoghegan & Mathis* had purchased a tract of land containing commercially marketable limestone. Traversing the central portion of the tract, on a right of way owned by a utility company, was a gas pipeline. In order to continue its mining operations, the taxpayer eventually had to obtain the release of the right of way in return for an alternative right of way and payment of the expenses of relocating the gas pipeline. The Tax Court and, on appeal, the Sixth Circuit held that the relocation expenditures were simply a part of the cost of acquiring a right of access to minerals, and therefore were to be treated as an additional investment in the taxpayer's mine and not as a mine development expenditure. *See* 453 F. 2d at 1328, *aff'g* 55 T.C. at 676.

lands to which the taxpayer owned the mineral rights. Several investigatory techniques were employed, including the establishment of grid systems staked out at 100-foot intervals, extensive sampling by means of core drilling, center pitting, and blasting, and the assaying of the samples taken. The district court held that, since all of the techniques employed by the taxpayer were in the nature of "exploration" activities, any expenditures resulting therefrom were exploration expenditures deductible only in part under section 23(ff) of the 1939 Code. 378 F. 2d at 74.

On appeal, the taxpayer conceded the validity of the determination that its expenditures resulted from "exploration" activities, contending only that *all* expenditures incurred after the discovery of commercially marketable quantities of ore are deductible as development expenditures under section 23(cc) of the 1939 Code (the predecessor to section 616(a) of the 1954 Code). *Id.* at 74–75. In rejecting the taxpayer's broad contention, the court, after noting that the term "development" is not defined by the Code, stated that it was proper

> to attribute the same meaning to the term as is generally ascribed to it by those whose activities the statute was designed to cover.
>
> As the district court found, the development of a mine or deposit is commonly understood by authorities in the mining field to mean the activity necessary to make a deposit accessible for mining. Cf. *Kennecott Copper Corp.* v. *United States*, 347 F. 2d 275, 281, 301–302 (Ct. Cl. 1965). [*Id.* at 75–76.]

In making the above statement, the court obviously was not attempting to comprehensively define the term "development" costs,[22] or to limit its application, in all cases, to costs incurred in the conduct of some physical activity. Defendant's contention that the court was attempting to do so is pure speculation.

Nor is it accurate to suggest that the decision in *Amherst Coal Co.* v. *United States*, *supra*, similarly stands for the proposition that *only* costs directly attributable to a physical mining activity are deductible as mine development costs.

[22] *See Estate of DeBie* v. *Commissioner*, 56 T.C. 876, 893 (1971); *Grossman & Johnson*, *supra* note 11, at 124.

In *Amherst*, the taxpayer had incurred certain expenditures in constructing access roads to two mines. Despite the Government's contention that the costs of constructing the roads were not deductible as development costs under section 616(a), the court held that the

> roads were necessary to allow access to the mine openings. They were, in the words of the [*Santa Fe*] case, "* * * activity necessary to make a deposit accessible for mining." Accordingly, the expenses incurred in their construction were development expenses, within the meaning of the statute. [295 F. Supp. at 441.]

In our view, that statement does not aid defendant. On the contrary, we think it supports our holding herein.

Thus, the only direct support for defendant's "activity" requirement is the *Geoghegan & Mathis* decision. *See* 453 F. 2d at 1328, *aff'g* 55 T.C. at 676. The Tax Court and Sixth Circuit opinions in that case, however, fail in our opinion to adequately distinguish between expenditures to acquire access rights at the time a mine is commencing production and similar expenditures incurred, for entirely different reasons, during the production stage of the mine. The *Manchester Coal Co.*[23] and *Denise Coal Co.*[24] decisions, cited

[23] 24 B.T.A. 577 (1931). In *Manchester*, the taxpayer had acquired by lease the right to strip mine the coal underlying certain lands owned by other parties. Because the lessor feared that it would be liable to the owners of the surface for any damage to the surface resulting from the removal of the coal, the lease was made subject to the condition that the taxpayer acquire title to the surface before commencing production. The taxpayer did so and then began production. When the taxpayer claimed deductions for the "depletion" of the surface, they were disallowed by the IRS on the ground that any reduction of the value of the surface resulting from its destruction in the course of the stripping operations could be realized as a loss when the land was ultimately sold. The Board of Tax Appeals, however, disagreed with the IRS, finding that the surface had been totally destroyed and, therefore, that

> "[t]he land now has no market or salable value, and there is no reasonable prospect of its ever having such a value.
>
> Under the facts here presented, where the land itself is destroyed or the coal is mined, we think that the cost of the land should be added to the cost of the coal in determining the depletion allowable." [24 B.T.A. at 582.]

[24] 29 T.C. 528 (1957), *aff'd on this point*, 271 F. 2d 930 (3d Cir. 1959). In *Denise*, the taxpayer had acquired various tracts of surface land overlying coal deposits which it owned or had the right to mine. For a period of 5 years, the taxpayer claimed deductions for the surface lands destroyed by stripping operations. When those deductions were denied by the IRS, the taxpayer filed suit in the Tax Court. Recognizing that "the fact situation was almost identical" to *Manchester Coal Co., supra*, the Tax Court held, on the basis of that case, that the taxpayer's expenditures to acquire the surface rights could be added to the depletion account, but could not be deducted as "ordinary and necessary" business expenses.

by the Tax Court as representing the "proper concept of the term 'development expenditures,'" 55 T.C. at 676, may have relevance in characterizing an expenditure undertaken when a mine is beginning production. As we indicated in *Kennecott*, however, they are of little value in deciding whether a similar expenditure, undertaken some 40 years after production had commenced, is "for the development of a mine" within the meaning of section 616(a). *See* 171 Ct. Cl. at 611, 347 F. 2d at 293.[25]

In the absence of a clear indication from Congress that only expenditures relating to a physical mining "activity" are deductible as mine development expenditures, we do not accept the restrictive view taken by the Tax Court and Sixth Circuit in *Geoghegan & Mathis*. In our opinion, the term "development" expenditures is sufficiently flexible to cover the necessary costs of acquiring access, *during the producing stage* of a mine, to areas in which to conduct additional development activities. None of defendant's arguments to the contrary are persuasive.

IV

In order to gain unfettered access to its lands to the east of the utility strip, plaintiff had to do two things. First, it had to acquire the utility strip itself and, secondly, it had to remove and relocate the transmission towers and lines located on the strip. Plaintiff accomplished its first objective by entering into an agreement with Niagara Mohawk pursuant to which plaintiff agreed to exchange certain of its lands for the utility strip.[26] To accomplish its second objective, plaintiff entered into a separate agreement pursuant to which Niagara

[25] It is not enough to contend, as defendant does, that, in other circumstances, the expenditures by plaintiff would be nondeductible capital expenditures under section 263. Int. Rev. Code of 1954, § 263. While that section does deny deductions for expenditures "paid out for new buildings or for permanent improvements or betterments made to increase the value of any property," the section is specifically made inapplicable to "expenditures for the development of mines or deposits deductible under section 616." *Id.*, § 263(a)(1)(A). The issue in this case is not, as defendant suggests, whether the costs of acquiring access to mineral-bearing lands are capital costs recoverable solely through the depletion allowances, but whether the particular expenditures at issue, under the facts of this case, are deductible as mine development expenditures under section 616(a).

[26] The agreement was entered into on September 19, 1962. The actual exchange of land took place in April 1963.

Mohawk consented to the removal and relocation of its transmission towers and lines in return for plaintiff's promise to pay the entire cost thereof.[27]

The mere fact, however, that the two agreements are component parts of a single plan does not mean, as defendant argues, that the agreements are so inextricably bound together that the costs incurred under the separate removal and relocation agreement are simply a part of the consideration that plaintiff paid for the utility strip. Our analysis of the stipulated facts and exhibits reveals quite the contrary—that the costs incurred under the agreement to remove and relocate the transmission towers and lines were *not* a part of the consideration that plaintiff paid for the utility strip. Plaintiff and Niagara Mohawk specifically state in the agreement providing for the exchange of lands that the

> parcels of land are of similar size and value and it is in the mutual best interests of both [parties] to exchange said lands *without any or other considerations passing from one party to the other.* [Stipulation of Facts, Exhibit G, at 2 (emphasis added).]

Although defendant would apparently have us ignore this provision, we think it is persuasive evidence that the removal and relocation agreement is simply what it purports to be—an agreement pursuant to which plaintiff was able to remove a physical obstruction and gain access in the most economical manner possible to lands which it already owned or to which it possessed quarrying rights. In this respect, the expenditures incurred by plaintiff are substantially similar to costs incurred in tunneling, stripping, or removing overburden, i.e., costs which are "necessary to make the ore or other mineral accessible." S. Rep. No. 781, 82d Cong., 1st Sess. 43 (1951).[28] Accordingly, the court finds, independent of *Ken-*

[27] This agreement was also entered into on September 19, 1962. Except for some preliminary work done in 1962, the removal and relocation was accomplished during 1963 and 1964. Plaintiff reimbursed Niagara Mohawk on February 23, 1965, for all costs incurred by the latter.

[28] When plaintiff's expenditures are viewed as resulting from the physical removal and relocation of the transmission towers and lines, rather than as simply a part of the consideration that plaintiff paid for the utility strip, it is clear that defendant's physical "activity" requirement is satisfied. It is immaterial that the removal and relocation work was done by another party on plaintiff's behalf. *See* Treas. Reg. § 1.616–1(a).

Syllabus

necott, that the costs incurred by plaintiff to remove and relocate Niagara Mohawk's transmission towers and lines are fully deductible as mine development expenditures under section 616(a).

CONCLUSION

For the foregoing reasons, the court concludes, as a matter of law, that plaintiff is entitled to deduct the $166,614 that it expended to remove and relocate Niagara Mohawk's transmission towers and lines as a mine development expenditure under section 616(a). It is therefore ordered that plaintiff's motion for summary judgment is granted to that extent and defendant's cross-motion for summary judgment is denied. The court also concludes that the $34,174 which plaintiff paid for the land acquired from Miller and Persons was a capital cost and was not an expenditure which is deductible under section 616(a). With respect to the $34,174, plaintiff's motion for summary judgment is therefore denied and defendant's cross-motion is granted. The case is remanded to the trial judge to determine the amount of plaintiff's recovery in accordance with this opinion.

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535 F. 2d 37

NORMAN M. GILLER & ASSOCIATES
v.
THE UNITED STATES

[No. 224–74. Decided May 12, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; cost principles; indirect costs; overhead; constructive salary; sole proprietorship.—Plaintiff, a sole proprietorship, entered into a cost-plus-fixed-fee contract with the United States to provide architectural and engineering services in Panama. The cost provisions of the contract provided that plaintiff would be reimbursed for its direct base salary costs of its employees and for indirect (overhead) costs. During contract performance, neither the sole proprietor, Mr. Giller, nor his wife, drew salary for their administrative services on behalf of the contractor firm nor was the firm ever charged therefor. After termination of the contract and a full audit of plaintiff's accounting methods, plaintiff claimed,

inter alia, constructive compensation for the administrative services of Mr. and Mrs. Giller. The Armed Services Board of Contract Appeals denied plaintiff's constructive compensation claim, concluding that the constructive compensation was unallowable as representing nothing actually paid, nor any company obligation charged or incurred. In sustaining the Board's decision, the court holds that the constructive costs of the alleged administrative services are not reimbursable under the indirect cost provisions of the contract. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Contracts; cost principles; indirect costs; overhead; constructive salaries.

[1] Where the Government was obligated under the cost provision of the subject cost-plus-fixed-fee contract to reimburse the contractor, a sole proprietorship, for only those items of indirect contract expenses as to which the contractor incurred a cost and paid, or incurred an obligation to pay, and where the contractor during the life of the contract incurred no cost for the sole proprietor's administrative services and made no payment to him nor incurred an obligation to pay him for such services, the constructive cost of such services is not reimbursable under the contract's indirect cost provisions. Although Federal Procurement Regulation, 41 C.F.R. § 1–15.205–6(a)(3) allows compensation in lieu of salary as alternative remuneration to sole proprietors, it is the contract not the regulation which governs whether such compensation is collectable from the Government. The regulation standing alone does not provide an entitlement to indirect cost reimbursement absent a contract clause obligating defendant to reimburse such costs.

United States ⇐ 70(18)

Mattaniah Eytan, for plaintiff. *Julius Kaplan*, attorney of record. *Kirkwood, Kaplan, Russin & Vecchi*, of counsel.

Marc J. Fink, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and DAVIS, *Judge*.

DURFEE, *Senior Judge*, delivered the opinion of the court:

This Wunderlich Act[1] review case concerns the entitlement of a sole proprietor of a cost-plus-fixed-fee contractor and his spouse to constructive compensation for administra-

[1] 41 U.S.C. §§ 321, 322 (1970).

tive services rendered in conjunction with a service contract, and first claimed after the termination of the contract.

Norman M. Giller & Associates, a professional architectural and engineering firm and a sole proprietorship owned and managed by Norman M. Giller individually, contracted on a cost-plus-fixed-fee basis with the Agency for International Development (AID) to provide various architectural and engineering services on several AID projects in the Republic of Panama. The contract provided that plaintiff would be reimbursed for its direct base salary costs of its employees in both its Florida home office and its Panama field office in accordance with cost provisions appended to and expressly incorporated in the parties' contract. Plaintiff's indirect (overhead) costs were to be reimbursed at 35% of its Panama direct contract costs and 50% of its home office direct contract costs. The parties' contract began in March 1962 with an estimated completion period of two years. Subsequent contract amendments extended the contract completion period to April 1966 with plaintiff's final report on the project submitted in May 1967.

Following expiration of the contract, AID conducted a final post-contract audit of plaintiff's costs under the contract. From this audit, defendant computed the amounts due plaintiff under the contract for both its direct and indirect costs and reimbursed plaintiff the outstanding amounts owing calculated pursuant to its final contract audit report.

Plaintiff protested defendant's final audit calculations claiming additional indirect costs reimbursable under the contract in the amount of $247,583. Of this amount, plaintiff claimed $79,685 as contractually allowable but unreimbursed overhead costs and $167,898 as constructive compensation for the administrative services performed by Mr. and Mrs. Giller for plaintiff during its performance of the contract. The claimed amounts had their genesis in a private professional audit of plaintiff's contract performance commissioned following plaintiff's dissatisfaction with the results of defendant's final audit report, and the Contracting Officer's refusal to make any adjustment in the Government's final audit report.

Plaintiff's private accountants conducted a thorough and comprehensive audit of plaintiff's contract performance. Concurrent with this audit, plaintiff's accountants converted plaintiff's books from a cash basis to an accrual basis. As part of their audit analysis, plaintiff's accountants added as an indirect contract expense an amount as constructive compensation to the Gillers for their administrative services for plaintiff during its activity under the contract and project.

During plaintiff's contract performance, Mr. Giller, as plaintiff's sole proprietor, drew no salary for his efforts on behalf of the firm. Mr. Giller performed largely administrative functions and ran the firm as opposed to doing actual professional architectural or engineering work. Mr. Giller did charge defendant for the small amount of engineering work he did perform on the contract. Mrs. Giller performed office "administrative work" and ran the firm in Mr. Giller's absence. Mrs. Giller drew no salary for the performance of these duties during the life of the contract. Plaintiff's books carried no entries for compensation to the Gillers for administrative work performed on behalf of the firm.

On presentation of plaintiff's private auditors' report, and the testimony of plaintiff's accountant to the Armed Services Board of Contract Appeals (Board) as part of plaintiff's appeal from the Contracting Officer's refusal to make adjustments to the Government's final audit report, the Board allowed plaintiff's claim for $79,685 in unreimbursed indirect contract costs. The Board denied, as an imaginary expense, plaintiff's claim for constructive compensation for the Gillers' performance of administrative services during the parties' contract. The Board concluded that "* * * the constructive compensation is unallowable as representing nothing actually paid, nor any company obligation charged or incurred." 73–1 BCA ¶10,016 p. 47,014.

In this action, plaintiff appeals the Board's denial of its constructive compensation claim. Originally, defendant sought to counterclaim for recovery of the $79,685 awarded plaintiff by the Board. After review of the administrative record, defendant retreated from this position and presently bases its defense solely on the validity of the Board's deter-

mination denying plaintiff's constructive compensation claim.

In their respective motions for summary judgment neither party disputes the Board's factual determinations which have been summarized above from the Board's reported decision. *Norman M. Giller & Associates*, ASBCA No. 14696, 73–1 BCA ¶ 10,016. Thus the sole issue before the court is the legal validity of the Board's denial of plaintiff's constructive compensation claim. For the reasons set forth below the Board's decision is sustained and defendant's summary judgment motion granted.

As its lead argument that the Board erred in denying plaintiff's constructive compensation claim, plaintiff contends that the Gillers should be compensated for their administrative services on commonsense principles relating to sole proprietorships because there is no sound business accounting method by which Norman M. Giller & Associates could have paid its sole proprietor, Norman M. Giller, a salary. This argument rests on the false assertion that a "sole proprietor cannot pay himself a salary." (Pltf's brief p. 14). This argument for which plaintiff tellingly provides no authority is both contrary to the decisions of the Board from whence plaintiff appeals and the Cost Principles applicable to plaintiff's contract.

In *Howard F. W. Taylor*, ASBCA No. 2876, 57–1 BCA ¶ 1204, the Armed Services Board of Contract Appeals allowed a proprietor's claim to a regularly collected appropriate salary as a general and administrative expense of the proprietorship's contract. Further, the Cost Principles applicable to P's contract provided that subject to certain restrictions salary amounts may be reimbursed to sole proprietors.

In determining whether plaintiff's constructive compensation claim is allowable, and the Board erred in denying the claim, it is the parties' contract rather than any commonsense principles of proprietorships which governs. Under the parties' contract defendant agreed to reimburse plaintiff for its direct contract performance costs determined in accordance with the contract's Cost Provisions. Defendant agreed to reimburse plaintiff for the indirect contract performance costs on a percentage basis of its direct costs. The

parties' contract sets forth defendant's reimbursement obligation of plaintiff's indirect contract costs as follows:

II—Indirect U.S. Dollar Costs

(a) Except as otherwise provided in Article III(a), indirect costs (overhead) allocable to the contract, shall be reimbursed periodically in amounts equal to the provisional percentages as set forth in Article III(a) of direct U.S. dollar authorized base salaries (excluding overseas salary differentials) paid by Contractor to the categories of employees specified in Article III(a) of the contract. Any provisional rate set forth in Article III(a) of the contract is based upon an analysis and evaluation by A.I.D. of relevant data relating to Contractor's overhead costs and is subject to revision annually as of the close of the Contractor's fiscal year to an actual rate on the basis of such annual or other audits as A.I.D. (or other appropriate U.S. Government agency) may make. Promptly following establishment of any actual overhead rate by any such audit, an appropriate adjustment will be made in the billings for the period covered by the audit subject to the application of the appropriate maximum rate set forth in Article III(a) of the contract. Any rate so established by audit or the appropriate maximum rate whichever is lower shall be used as a provisional rate for the ensuing fiscal year. Payments for subsequent fiscal years shall be computed and adjusted in the same manner.

(b) Allowable overhead items will normally include those indirect expenses of the Contractor's home office which are properly allocable to the contract by methods in accord with those generally accepted accounting principles which are applicable under the circumstances. The objective sought in such allocations is to distribute fairly and equitably to the contract, on the basis of the benefit received or in proportion to the cause of the incurrence of the expense, a reasonable share of the cost of each allowable item of indirect expense. Direct costs which are not allowable as such shall not be allowable as indirect costs.

(c) Examples of items which are allowable may include reasonable salaries paid to partners, principals, officers and other direct employees; social security taxes, workmen's compensation insurance, payments under established pension, retirement, group health, accident and life insurance and incentive payment plans, and vacation, holiday and severance pay, sick leave and military

> leave pay all to the extent that such items are not included in the direct costs authorized by the contract; also legal and accounting expense, new business activities, clerical and stenographic work, general accounting, personnel, office and drafting room supplies, depreciation of buildings, office and drafting room furniture and equipment and/or amortization of leasehold improvements, local telephone service, rent of office space and equipment, utilities, nonallocable time of engineers, draftsmen and other technical employees.

Under the above Cost Provision of the parties' contract defendant obligated itself to reimburse plaintiff for only those items of indirect contract expenses as to which plaintiff incurred a cost and paid or incurred an obligation to pay. As plaintiff incurred no cost for the Gillers' administrative services and made no payment or incurred an obligation to pay the Gillers for their administrative services, the constructive cost of these services are not reimbursable under the indirect cost provisions of the parties' contract and the Board committed no error in denying the claim "* * * as nonreimbursable under any theory or computation of the contract costs." 73–1 BCA ¶10,016 p. 47,009.

It should be noted that even if plaintiff were entitled to a claim for its proprietor's administration of the contract such a claim would have to be measured by the value of Mr. Giller's services alone as the record does not reflect that Mrs. Giller stood in a proprietor, partner, management or ownership position to plaintiff.

Plaintiff points to both the Federal Procurement Regulations [2] and the Armed Services Procurement Regulations as entitling plaintiff to compensation for the Gillers' administrative services. Specifically plaintiff relies on Federal Procurement Regulation § 1–15.205–6(a)(3)[3] which provides:

> Compensation in lieu of salary for services rendered by partners and sole proprietors will be allowed to the extent that it is reasonable and does not constitute a distribution of profits.

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[2] Subpart 1–15.2 of the Federal Procurement Regulations was specifically incorporated into the parties' contract with the exception that in the event of conflict between the regulations and the contract's Cost Provisions, the latter would govern.

[3] 41 C.F.R. § 1–15.205–6(a)(3) (as of Jan. 1, 1963).

Opinion of the Court

As the above regulation provides that compensation in lieu of salary "will be allowed" to sole proprietors, plaintiff contends that the Board erred in denying its constructive compensation claim. While the above cited regulation allows compensation in lieu of salary as alternative remuneration to sole proprietors for their efforts, it is the contract itself rather than the regulation which must govern whether such compensation is collectable from defendant.

Plaintiff has framed its claim as one for recovery of indirect overhead expenses on account of the Gillers' rendering of administrative services during the four-year life of the parties' contract. The contract provided that plaintiff's indirect contract expenses would be reimbursed in accordance with the Cost Provision set forth above. That Cost Provision governing defendant's reimbursement obligation of plaintiff's indirect costs, as previously discussed, makes no provision for reimbursement of indirect costs which are not either actually expensed or paid. As plaintiff during the life of the contract neither expensed nor paid the Gillers for their administrative services such constructive costs are not reimbursable as indirect contract costs. While the cited Federal Procurement Regulation permits defendant to allow sole proprietors compensation in lieu of salary, it is the contract which must provide for that allowance. The regulation standing alone does not provide an entitlement to indirect cost reimbursement in the absence of a contract clause obligating defendant to reimburse plaintiff for such costs. Thus the Board's conclusion that "* * * nothing in [the Federal Procurement Regulations], or about the policy thereunder, suggests the reimbursement of an unrealized expense or charge." 73–1 BCA ¶10,016 p. 47,014, is both accurate and legally correct.

Lastly, plaintiff urges that analogous tax decisions, considerations other than whether plaintiff paid or incurred an obligation to pay the Gillers for their administrative services and defendant's failure to conduct annual audits as provided in the contract, justify plaintiff's recovery of constructive compensation for the Gillers' administrative services. Consideration of this collage of justifications provides no valid basis for overriding the terms of the parties' contract

or overruling the Board's decision denying plaintiff's claim. While plaintiff maintains that defendant's failure to conduct an annual audit of plaintiff's contract performance as provided in the contract, prevented it from realizing that the Gillers were not being compensated for their administrative services it fails to validly explain how such an audit of plaintiff's contract performance cost records would have alerted either party to the cost of the Gillers' services of which there was no record.

Further weakening plaintiff's argument over the recovery of its constructive compensation claim is the fact that defendant did conduct one audit of plaintiff's contract performance at the end of its first year of contract performance. Following that audit the parties held several conferences to resolve differences over the audit. At no time during these discussions did compensation for the Gillers' administrative services surface as a disputed issue. As the issue of compensation for the Gillers did not surface in defendant's audit of plaintiff's contract performance or the extensive discussions following that audit, there is little basis for speculating, as plaintiff does, that it would have surfaced in subsequent audits.

A thorough review of the record with attention to the facts that plaintiff's constructive compensation claim arose only after the termination of the contract, and then only after a full private audit of plaintiff's accounting methods, lends credence to defendant's view that the Gillers, as proprietors of plaintiff, considered themselves satisfactorily compensated for their administrative duties from the outset of their multi-year contract by the contract's fixed-fee, and that the instant claim amounts to a contrived attempt to recover from defendant an imaginary cost. Plaintiff's arguments have failed to convincingly demonstrate error in the Board's decision denying plaintiff's constructive compensation claim, or that plaintiff has in fact a legitimate unsatisfied claim against defendant.

Accordingly, defendant's cross-motion for summary judgment is granted. Plaintiff's summary judgment motion is denied, and its petition dismissed.

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535 F. 2d 42

VALLEY VIEW SHOPPING CENTER LTD. v. THE UNITED STATES

[No. 96–75. Decided May 12, 1976]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Small business investment program; lease rental guarantee insurance policy; default in rental payments.—Plaintiff seeks to recover the proceeds of a lease rental guarantee insurance policy written by the Small Business Administration (SBA) under the provisions of the Small Business Investment Act of 1958. Plaintiff-lessor and Central Cinema Company, Inc., lessee, executed a 15-year lease to commence in June 1972 for space in a shopping center at a stated monthly rental. In June 1972 SBA issued a lease rental guarantee insurance policy to lessee, naming plaintiff beneficiary. Thereafter plaintiff received only sporadic rental payments. On May 2, 1973 plaintiff sent a written notice of default in payments to lessee and SBA; on June 6, 1973 plaintiff advised SBA of its intention to terminate the tenancy and to file claims under the insurance policy; and on June 14, 1973 plaintiff filed such a claim. The claim was denied by the SBA regional office and the Washington agency headquarters. Defendant contends that under the terms of the policy's "insuring agreement" plaintiff is not entitled to recover from SBA rents which accrued prior to the notice of default. It is *held* that a default for insurance policy purposes is "any" failure to perform a lease covenant which results in a written demand for possession, and here the missed rent payments between the inception of the term and May 2, 1973 resulted in a written demand for possession on that date. Each of the missed payments occupies the category of default as defined in paragraph 1(f) of Part II of the "insuring agreement." Plaintiff is entitled to recover from SBA past-due rent, up to 75% of the lease rental figure and subject to the 3-month rent deductible endorsement as provided in the policy, which accrued prior to plaintiff's formal notice of default in payments. It is also *held* that plaintiff acted in a timely manner in apprising SBA of the missed payments. Defendant's motion for summary judgment is denied, plaintiff's cross-motion is allowed, and judgment is entered for plaintiff on liability, the amount of recovery to be determined in further proceedings.

Contracts; interpretation; ambiguity.

[1] Where a contract provision is ambiguous and the contrary interpretations of the contracting parties are within the zone of reasonableness, doubt will be resolved against the party who drafted

the questioned language, as against others who relied on it in good faith.

Contracts ⇐ 155

Small business investment program; lease guarantee; default in rental payments; legislative intent.

[2] Since the small business investment program was enacted to make commercial and industrial property leases available to small business, the goal would largely be defeated if the court in contravention of the basic purposes of the governing legislation set down an ironclad rule requiring the lessor-beneficiary to forego the exercise of judgment and to initiate termination of the small business lease instantly with the first late rental payment in order to protect its rights under the participation insurance policy. A default for insurance policy purposes is "any" failure to perform a lease covenant which results in a written demand for possession.

United States ⇐ 57

Statutes; construction and operation; absurdity.

[3] The courts will not subscribe to an interpretation of contractual language which produces an absurd or whimsical result.

Contracts ⇐ 154

Small business investment program; lease guarantees; default in rental payments; notice of default; limitation of actions.

[4] The import of the limitations period for commencing an action against the Small Business Administration for recovery of a claim under the insurance policy implementing the small business investment program is that the lessor-beneficiary has a "reasonable" time within which to determine that the lessee has no prospect of paying all or a portion of the insured rent. When, by reason of one or more missed rental installments, existence of loss first becomes evident in reasonable contemplation, the lessor must give notice of default and initiate collection efforts against SBA in the appropriate administrative or judicial proceedings within not more than 2 years.

United States ⇐ 74(1)

Robert J. Campbell, attorney of record, for plaintiff.

Donnie Hoover, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, NICHOLS, and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

Plaintiff brings this suit seeking judgment for certain proceeds of a "lease rental guarantee insurance policy" written by the Small Business Administration (SBA) and

running to plaintiff as beneficiary. First enacted in section 316(a) of the Housing and Urban Development Act of 1965, 79 Stat. 482 (now codified in 15 U.S.C. § 692 (1970)), section 401 of the Small Business Investment Act of 1958 allows SBA in its discretion to guarantee payment of rentals under leases of commercial and industrial property entered into by qualified small business concerns, all to the end of creating an inducement for property owners to rent business properties to small business tenants.[1] The parties' research, as well as our own, indicates that no reported decisions have to date examined this provision of law. As more particularly described below, the instant case involves an insured landlord who could not collect from its tenant and was forced, when efforts to accommodate the needs of the tenant failed, to call upon SBA to make good its obligation as guarantor of defaulted rent.

The cross-motions for summary judgment, exhibits, and supporting briefs show that there is no genuine dispute as to any material fact. The case is ripe for decision at this time under Rule 101. We agree with the position of the plaintiff for reasons given below.

On April 6, 1971, Central Cinema Company, Inc. (CCC), as lessee, and plaintiff, as lessor, executed a lease for space in the Valley View Shopping Center, Overland Park, Kansas. The lessor demised to the small business lessee a term of 15 years to commence in June 1972, reserving a minimum monthly rental of $3,612.50. The SBA, on June 10, 1972, issued a "lease rental guarantee insurance policy" to CCC,

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[1] 15 U.S.C. § 692 (1970) provides in pertinent part:

"(a) *Non-availability of guarantees from other sources; participation with qualified sureties.*

"The Administration may, whenever it determines such action to be necessary or desirable, and upon such terms and conditions as it may prescribe, guarantee the payment of rentals under leases of commercial and industrial property entered into by small business concerns to enable such concerns to obtain such leases. Any such guarantee may be made or effected either directly or in cooperation with any qualified surety company or other qualified company through a participation agreement with such company. * * *."

A member of the SBA General Counsel's staff once said: "The purpose of this guarantee authority is to enable a small busines without blue-chip credit to obtain space in a good location that is usually available only to a triple-A credit business. The program was initially proposed for use in shopping centers, * * *." R. D. Turner, *A Cryptic Resource for Small Business*, 57 A.B.A.J. 691, 694 (1971).

naming plaintiff as beneficiary. The policy undertook to guarantee payment of up to 75 percent of the rent set forth in the lease. The total "guaranteed rent" for the 15-year term was $487,620, subject to a "three-month rent deductible endorsement." Thus, SBA's liability as guarantor was limited to rent which might accrue to the lessor subsequent to the first 3 months of any default in payment by CCC.

Plaintiff and defendant agree that CCC paid its rent only sporadically after the term commenced. Defendant takes no issue with an exhibit filed by plaintiff showing that the check drawn by CCC to plaintiff's order for July 1972 rent was returned for lack of sufficient funds on deposit with the drawee. On May 2, 1973, plaintiff sent a written notice of the tenant's default simultaneously to CCC and to SBA, listing past-due rent and charges in the amount of $26,472.61.[2] A further notice dated June 6, 1973, advised SBA of the lessor's intention to terminate CCC's tenancy and to file claims under the policy. A claim for insurance benefits was filed on June 14, 1973, of which defendant has paid no part. Both the SBA regional office in Kansas City and the Washington agency headquarters took the position that SBA's liability under the insurance policy attached only for past-due rent payments accruing to the lessor *after* (1) formal notice of default was served (here, May 2, 1973) and (2) the 3-month deductible period thereafter had gone by. So, in SBA's view, the deductible period ended August 1, 1973, and its obligation thereafter would be reduced by the amount of rent paid by the new tenant. Hence, SBA maintained then, as it maintains in this court, that it encounters no liability at all since the property was rented to a new tenant in August. Plaintiff filed its petition here on April 23, 1975.

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[2] This notice was required by 13 C.F.R. § 106.11(b) (1973):

"Upon the occurrence of a default by the lessee under the insured lease, the lessor shall give written notice simultaneously to the lessee and to the insurer of the specific default."

Paragraph 9, Part II, of the policy provides: "Upon the occurrence of a default as defined herein the Lessor shall simultaneously give written notice to the Lessee and to SBA. Unless the default is corrected within 30 days from the date of notice of default, the Lessor shall, within 10 days thereafter give SBA notice that it is taking action to terminate the occupancy of the Lessee and intends to file claims. This notice shall include the total amount of unpaid guaranteed rent and the dates on which each unpaid installment was due, * * *."

The principal issue framed for our decision by the parties is whether under this insurance policy the lessor-beneficiary is entitled to recover past-due rent from SBA accrued prior to plaintiff's formal notice of default. Defendant answers this in the negative, referring us to the words found in the policy's "insuring agreement":

> The Small Business Administration (* * * hereinafter called "SBA") agrees with the Lessee, in consideration of the payment of the premium * * * subject to all of the terms and conditions of Part II, to guarantee the payment of that portion of the Insured Rent which *shall be due* and unpaid to the Lessor during the policy period *by reason of the Lessee's default.* [Emphasis added.]

The term "default" is defined in Part II, Conditions, paragraph 1(f):

> (f) Default—Any failure by Lessee to perform any of the covenants and conditions of the Lease, *which results in a written demand for possession* by Lessor, shall constitute a "default". [Emphasis added.]

Defendant first observes that a "default" within the meaning of the policy differs from a default under the lease. While a failure to pay rent might ordinarily be considered a default under the *lease*, such failure of payment does not assume the status of default as the term is understood in the *policy* until such time as the lessor provides "a written demand for possession." Thus, while the rent may go unpaid for months, no default occurs under the *policy*, defendant tells us, unless and until the lessor makes it a default by giving a written demand for possession. Under this concept only the final failure of payment by the lessee—being the failure which precipitates the demand—constitutes a default. Defendant then bolsters its position by emphasizing the words "Insured Rent which *shall* be due [emphasis added]." Use of the future tense indicates to defendant the meaning that only rent becoming due *after notice* of default falls within the coverage of the policy, subject to the 3-month deductible endorsement. Defendant tells us that this technical interpretation must be approved so that a lessor will not sit idly by, declaring a default only when most advantageous to it and thereby maximizing the liability of SBA.

We do not attach much weight to the argument that unless we adopt defendant's interpretation, lessors will allow defaulted rent to accumulate. First, the policy in this case covered only 75 percent of the rent reserved in the lease. Moreover, during the time the lessor would allow rent to accrue without notice of default it would not have the use of the funds. It does not seem reasonable to expect that an insurance beneficiary would be content to do nothing while, as a practical matter, accumulating nothing more than a claim to 75 percent of that which may be presumed to be the reasonable value of the leased premises. The consequences defendant conjures up are imagined, not real.

Other language in the policy indicates that its coverage reaches back in time, compensating for rent which is past due at the time of a formal notice of default. Thus, in paragraph 9, Part II, it is said:

> * * * This notice [the notice of default] shall include the *total amount of unpaid guaranteed rent* and the dates on which *each unpaid installment was due*, * * *. [Emphasis added.]

In paragraph 12(c), Part II, the policy continues:

> * * * The Lessor's claim and SBA's liability shall be limited to that portion of the Insured Rent which is due and payable without regard to any provision of the Lease the effect of which is to accelerate the due date of any installment. * * *.

"Insured rent" is defined in paragraph 1(h) of Part II as—

> * * * the *total of the unpaid installments* of the aggregate amount of guaranteed rent set forth in Part I, which shall be due the Lessor during the policy period under the terms of the Lease * * *. [Emphasis added.]

Finally, the first sentence of paragraph 9, Part II,[3] provides:

> * * * Upon the occurrence of a default *as defined herein* the Lessor shall simultaneously give written notice to the Lessee and to SBA. * * *. [Emphasis added.]

This wording belies defendant's interpretation of default for policy purposes. If a policy default obtains only upon

[3] *See* note 2, *supra*.

notice and demand for possession, as defendant maintains, then the *additional* notice obligatory under paragraph 9 becomes entirely meaningless, as well as the definition of insured rent in paragraph 1(h), Part II.

The most charitable observation which can be made, so far as defendant's position is concerned, is that the insuring agreement in Part I of the policy suffers from some latent ambiguity in delimiting the scope of coverage. Assuming for discussion that defendant's interpretation resides within the zone of reasonableness, so too does plaintiff's. Accordingly, the doubt will be resolved against the party who drafted the questioned language, as against the others who relied on it in good faith. *H & M Moving, Inc.* v. *United States*, 204 Ct. Cl. 696, 499 F. 2d 660 (1974); *United Pac. Ins. Co.* v. *United States*, 204 Ct. Cl. 686, 497 F. 2d 1402 (1974); *Blount Bros. Constr. Co.* v. *United States*, 171 Ct. Cl. 478, 346 F. 2d 962 (1965); *WPC Enterprises, Inc.* v. *United States*, 163 Ct. Cl. 1, 323 F. 2d 874 (1963); RESTATEMENT, CONTRACTS § 236(d) (1932).

More fundamentally, however, we should hestitate to adopt a construction which would contravene the basic purposes of the governing legislation. We have observed, heretofore, that the lease guarantee program was enacted to make commercial and industrial property leases available to small business.[4] That goal would largely be defeated if we set down an ironclad rule which would require a lessor to forego the exercise of any judgment and to initiate termination of the small business lease instantly with the first late rent payment in order to protect its rights under the policy. The courts will not subscribe to an interpretation of contractual language which produces an absurd or whimsical result. *Northwest Marine Iron Works* v. *United States*, 203 Ct. Cl. 629, 637, 493 F. 2d 652, 657 (1974). We think the basic policy promise should be enforced according to its tenor: that SBA will pay the lessor such insured rent as the lessee fails to pay during the policy period, subject naturally to the further conditions set forth in the contract. A default for policy purposes is "any" failure to perform a lease covenant which results in a written demand for possession. In

[4] *See* note 1, *supra*, and 13 C.F.R. § 106.2 (1973).

the present case, all of the missed rent payments between the inception of the term and May 2, 1973, resulted in the written demand for possession on that date. Each of such missed payments occupies the category of default as defined in paragraph 1(f) of Part II, since a written demand for possession based thereon was transmitted simultaneously to the tenant and SBA on May 2, 1973.

We caution, however, that we do not countenance undue delay on the part of any insured lessor in apprising SBA of missed rent payments by appropriate declaration of default. Under paragraph 17 of Part II, the policy provides:

> * * * No suit or action for recovery of any claim under the Policy shall be initiated in any court of Law or equity or in any administrative proceeding unless all of the conditions of the Policy shall first have been complied with and unless such suit or action is commenced within two (2) years after the earliest date on which the existence of the loss can be reasonably determined.

The import of this language is that the lessor has a "reasonable" time within which to determine that the tenant has no prospect of paying all or a portion of the insured rent. Thus, one need not necessarily jump at the first late payment. But when by reason of one or more missed rental installments existence of loss first becomes evident in reasonable contemplation, the lessor must give notice of default, and initiate collection efforts against SBA in the appropriate administrative or judicial proceedings within not more than 2 years. Thereafter the claim is wholly barred. We will have no difficulty in giving effect to this policy provision, for SBA may grant lease guarantees "upon such terms and conditions as it may prescribe." 15 U.S.C. § 692 (1970).

In the instant case we are satisfied that the insured lessor acted in a timely manner. The undisputed evidence shows that partial payments were made by CCC as late as February 12, 1973. Between January 8 and February 12, in fact, the tenant made partial payments on account totaling $7,780.09. Less than 3 months later plaintiff protected its rights by giving notice of default, and within 2 years of this notice plaintiff exhausted its administrative remedy and filed a pe-

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tition here. We think plaintiff acted with reasonable diligence and ought to be paid.

Defendant's motion for summary judgment is denied, and plaintiff's cross-motion for summary judgment is allowed. Judgment is entered for plaintiff on liability and the case is remanded to the Trial Division for computation of the amount of recovery pursuant to Rule 131(c), in accordance with the foregoing opinion.

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535 F. 2d 47

S. SANFORD LEVY AND SUCCESSION OF MRS. MARY PHENE VETERS LEVY (S. SANFORD LEVY, TESTAMENTARY EXECUTOR) v. THE UNITED STATES

[No. 172-75. Decided May 12, 1976]

ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Taxes; income tax; deductions; judicial reelection expenses; campaign costs and qualification fee.—In 1972 in an effort to seek reelection as a state judge, plaintiff paid a qualification fee to the State General Committee and incurred certain miscellaneous campaign expenses; on his tax return for that year he claimed a deduction for these expenses. The Internal Revenue Service disallowed the deductions and assessed a deficiency; plaintiff paid the deficiency; upon denial of his refund claim plaintiff brought this suit seeking a refund of the deficiency, plus interest. Plaintiff contends that his 1972 costs are deductible under subsection 162(a) or 212(1) of the Internal Revenue Code of 1954 as expenses directly deductible from ordinary income or as capital investment amortizable over the term of his judgeship. It is *held* that the Supreme Court decision in *McDonald* v. *Commissioner*, 323 U.S. 57 (1944), the rationale of various circuit court cases, and congressional intent evidenced by subsection 162(e)(2)(A) mandate denial of plaintiff's claims either for a direct deduction or for amortization of the expenses. Defendant's motion for summary judgment is granted and the petition is dismissed.

Taxes; income tax; deductions; expenses; judicial reelection expenses; campaign costs.

[1] In computing federal income tax liability, miscellaneous campaign expenditures incurred by a judge seeking reelection are not directly deductible under either subsection 162(a) or 212(1) of the Internal Revenue Code of 1954 because they are not "ordinary and

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necessary expenses" of being a judge. There is not sufficient analogy between employment agency fees (held by the Tax Court to be allowable deductions) and campaign expenses of a judge seeking reelection to upset decisions by the Supreme Court and circuit courts, particularly in light of subsection 162(e)(2)(A).

Internal Revenue ⇐ 541

Taxes; income tax; deductions; expenses; judicial reelection expenses; qualification fee.

[2] A qualification fee paid to the State Central Committee by a state judge seeking reelection is a nondeductible expense incurred in attempting to be a judge as opposed to a fee properly deductible under either subsection 162(a) or 212(1) of the Code as an expense incurred in carrying out the judicial function.

Internal Revenue ⇐ 541

Taxes; income tax; deductions; expenses; judicial reelection expenses; campaign costs.

[3] Rev. Ruling 71–470 allowing a deduction for a public officials expenses incurred pursuant to fighting a recall from office is insufficient to overcome the result mandated by the Supreme Court in *McDonald* v. *Commissioner*, 323 U.S. 57 (1944), and circuit court decisions, as well as subsection 162(e)(2)(A), that campaign expenses and a qualification fee incurred by a judge seeking reelection are not directly deductible under subsections 162(a) and 212(1).

Internal Revenue ⇐ 541

Taxes; income tax; deductions; expenses; judicial reelection expenses; campaign costs, etc.

[4] Having failed to obtain a subsection 162(a) or 212(1) direct deduction for campaign expenses and qualification fee incurred in seeking reelection to a judgship, plaintiff cannot achieve the same result through amortization of these expenses over the terms of his judicial office.

Internal Revenue ⇐ 541

Taxes; income tax; deductions; expenses; reelection expenses; campaign costs, etc.

[5] If deductions are to be allowed for campaign expenditures by candidates seeking reelection to public office, Congress, not the courts, must so provide.

Constitutional Law ⇐ 70.1(7)

S. Sanford Levy, Pro se.

Theodore D. Peyser, *Donald H. Olson*, and *George L. Squires*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant.

Opinion of the Court

Before COWEN, *Chief Judge*, NICHOLS and KUNZIG, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court.

Plaintiff [1] brings this income tax refund suit seeking a deduction for various expenses incurred in obtaining reelection to his position as a state court judge. Because such expenses are not deductible under the Internal Revenue Code, we hold for defendant.

Plaintiff was first elected judge of the district court for New Orleans, Louisiana, in 1966. Later, during his successful 1972 reelection effort plaintiff paid a $550 qualification fee to the "State Central Committee" and also incurred $14,403.-20 in miscellaneous campaign expenses. Plaintiff deducted both the qualification fee and the campaign expenses from his 1972 income. The Internal Revenue Service (IRS) disallowed the deduction and assessed a deficiency. Plaintiff paid the deficiency and after his refund claim was denied by the IRS, timely brought the present action seeking a refund of the deficiency, plus interest.

Defendant enters a motion for summary judgment, arguing that the instant reelection expenses are not deductible under the Internal Revenue Code. Plaintiff opposes the motion contending that his 1972 reelection costs are deductible under subsections 162(a) or 212(1) either (1) as expenses *directly deductible* from ordinary income or (2) as *capital investment* amortizable over the term of the judgeship. Because the reelection expenses in question are not deductible under the provisions of subsections 162(a) or 212(1), as analyzed below, we grant defendant's motion for summary judgment and dismiss plaintiff's petition.

(1) Direct deduction:

In support of his initial contention, plaintiff argues that subsections 162(a) or 212(1) of the Internal Revenue Code of 1954 allow him to deduct the reelection expenses directly

[1] For convenience only Judge Levy is referred to as plaintiff. The estate of the Judge's deceased wife is also a party to this suit because the tax return in question was originally filed as a joint return.

from his 1972 income.[2] The expenses in question take two forms: miscellaneous campaign costs and the qualification fee. Each of these expenses will be separately considered to determine if either is properly deductible directly from plaintiff's 1972 income.

The first expense considered is the miscellaneous campaign expense. The Supreme Court's decision in *McDonald* v. *Commissioner*, 323 U.S. 57 (1944) clearly compels denial of plaintiff's attempt to deduct campaign costs directly from his 1972 income.

In *McDonald*, the Court specifically held that the miscellaneous reelection expenses of a Pennsylvania judge were not deductible under either subsection 23(a)(1)(A) or 23(a)(2) of the Internal Revenue Code of 1939.[3] The claim to a subsection 23(a)(1)(A) (§ 162(a)) *business deduction* was denied on the grounds that the campaign costs *were not an "ordinary and necessary"* expense. The Court drew a crucial distinction between the costs of performing the judicial function (deductible as ordinary and necessary) and expenditures during the effort to secure the position (nondeductible).

> [The judge's] campaign contributions were not expenses incurred in being a judge but in trying to be a judge for the next ten years. [*McDonald*, *supra* at 60].

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[2] Subsection 162(a) provides in part:

"There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *."

Subsection 212(1) specifies:

"In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—(1) for the production or collection of income * * *."

[3] Subsection 23(a)(1)(A) of the 1939 Code is the immediate predecessor of subsection 162(a) of the 1954 Code. The language construed by the Court in *McDonald* is identical to that which plaintiff now attempts to use in subsection 162(a) of the 1954 Code.

"In computing net income there shall be allowed as deductions * * * all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *." [§ 23(a)(1)(A), Int. Rev. Code of 1939].

In addition, subsection 23(a)(2) of the 1939 Code is essentially identical to subsection 212(1) of the 1954 Code, also relied on by plaintiff in the instant action.

"In computing net income there shall be allowed as deductions * * * [i]n the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income * * *." [§ 23(a)(2), Int. Rev. Code of 1939].

To compare the provisions of the 1939 Code with those of the current Code, *see* note 2, *supra*.

Clearly, plaintiff's campaign expenses in the instant case stand on the same footing as those in *McDonald*. They are not deductible directly from income either under subsection 162(a) or 212(1) because they are not "ordinary and necessary expenses" of being a judge.

Further evidence of a Congressional intent to disallow deductions for campaign expenses is found in a more recent amendment to section 162. Subsection 162(e)(2)(A) specifically prevents deduction of political campaign expenses which might otherwise be deductible under subsection 162(e)(1) (expenses incurred in connection with legislative appearances or legislative interests of a taxpayer).[4] This amendment presents a vivid example of Congressional reluctance to allow deduction of campaign costs.

Although the Court of Claims has never decided the question of deductibility of judicial campaign expenses under subsection 162(a) or 212(1), several other circuit courts have uniformly applied *McDonald* to deny such deductions. *Nichols* v. *Commissioner*, 511 F. 2d 618 (5th Cir. 1975), *aff'g* 60 T.C. 236 (1973), *cert. denied*, 423 U.S. 912 (1975); *Maness* v. *United States*, 367 F. 2d 357 (5th Cir. 1966), *cert. denied*, 386 U.S. 932 (1967); *Campbell* v. *Davenport*, 362 F. 2d 624 (5th Cir. 1966); *Shoyer* v. *United States*, 290 F. 2d 817 (3rd Cir. 1961), *cert. denied*, 368 U.S. 835 (1961); *Carey* v. *Commissioner*, 56 T.C. 477 (1971), *aff'd*, 460 F. 2d 1259 (4th Cir. 1972), *cert. denied*, 409 U.S. 990 (1972). The unanimity of such decision lends even more force to the instant denial of a subsection 162(a) or 212(1) direct deduction for plaintiff's miscellaneous campaign expenses.

Having determined that plaintiff may not directly deduct the campaign expenses from income by use of subsections 162(a) and 212(1), we turn to the question of plaintiff's $550 qualification fee. The Supreme Court was also faced with a similar expenditure in addition to the campaign ex-

[4] Subsection 162(e)(2)(A), added by Pub. L. No. 87-324, § 3(a)(1962) provides:

"The provisions of paragraph (1) shall not be construed as allowing the deduction of any amount paid or incurred * * * for participation in, or intervention in, any political campaign on behalf of any candidate for public office * * *." § 162(e)(2)(A), Int. Rev. Code of 1954].

penses in *McDonald*, *supra*. The Court disallowed the Pennsylvania judge's attempts to deduct a "State party assessment," again rejecting any application of the predecessors to subsections 162(a) and 212(1).

The "assessment" in *McDonald* is almost indistinguishable from the "qualification fee" involved in the case at bar. Moreover, like the reelection expenses in *McDonald*, the qualification fee in the instant action represents nondeductible expenses incurred in attempting to be a judge as opposed to properly deductible expenses incurred in carrying out the judicial function. *See, e.g., Nichols*, *supra* (statutory qualification fee held not deductible); *Campbell*, *supra* (assessment by county executive committee held nondeductible). In short, like his campaign expenses, plaintiff's qualification fee is not directly deductible from income either under authority of subsection 162(a) or 212(1).

Plaintiff attempts to overcome the thrust of *McDonald*, subsection 162(e)(2)(A), and other case law by urging that the trend of recent Tax Court decisions has been to allow deductions for expenses incurred in seeking new employment. *Black* v. *Commissioner*, 60 T.C. 108 (1973); *Primuth* v. *Commissioner*, 54 T.C. 374 (1970). However, the Tax Court has clearly rejected application of this trend to *campaign expenses*. *Carey* v. *Commissioner*, 56 T.C. 477 (1971), *aff'd* 460 F. 2d 1259 (4th Cir. 1972) distinguished deductible new employment expenses from nondeductible campaign expenses.

> Unlike employment agency fees, we do not think that common understanding in the ordinary affairs of life would consider that campaign expenditures should be encompassed as 'ordinary and necessary expenses * * *.' [*Carey*, *supra*, 56 T.C. at 481].

We agree that there is not a sufficient analogy between employment agency fees and campaign expenses to upset decisions by the Supreme Court and various circuit courts, particularly in light of subsection 162(e)(2)(A).

Plaintiff further urges application of Revenue Ruling 71-470, 1971-2 Cum. Bull. 121 (1972), to the case at bar. In this ruling, the IRS allowed a deduction for a public official's expenses incurred pursuant to fighting a *recall*. The distinc-

tion between election expenses incurred in obtaining a position and recall expenses paid *to retain* the job is obvious. Moreover, this Revenue Ruling is insufficient to overcome the result mandated by the Supreme Court and circuit court decisions and subsection 162(e)(2)(A).

In short, plaintiff cannot use subsection 162(a) or 212(1) directly to deduct from income either the campaign expenses or the qualification fee.

(2) Amortization:

Failing to obtain a direct deduction from income for the instant expenses, plaintiff attempts an alternative. In this second "tack," plaintiff argues that he should at least be allowed to treat the expenses as a capital investment and amortize or deduct them each year during the term of his office.

While such an approach carries a certain theoretical appeal in terms of good accounting practice, plaintiff cannot escape the fact that his proposed amortization, if permitted, would still involve deducting expenses incurred in "trying to be a judge." Whether plaintiff deducts the expenses during the campaign year or spreads the deductions over the term of his judicial office, he is still attempting to deduct expenses for campaigning. *McDonald* and the circuit court cases discussed, *supra*, clearly forbid such deductibility. Having failed to obtain a subsection 162(a) or 212(1) direct deduction for the campaign expenses or qualification fee, plaintiff cannot achieve the same result through amortization. *See Maness* v. *Commissioner*, 367 F. 2d 357 (5th Cir. 1966); *Mays* v. *Bowers*, 201 F. 2d 401 (4th Cir. 1953).

In summary, the instant case presents the question of whether or not plaintiff is entitled to a subsection 162(a) trade or business expense deduction or a subsection 212(1) individual deduction for miscellaneous campaign expenses and a qualification fee incurred during reelection efforts in a Louisiana judicial election. The Supreme Court decision in *McDonald*, *supra*, the rationale of various circuit court cases, and Congressional intent evidenced by subsection 162(e)(2)(A) mandate denial of plaintiff's claims either for a direct deduction or for amortization of the expenses in question.

Syllabus

While good accounting practice might lead one to agree with plaintiff's position, the question of deduction of campaign expenses is presently a closed issue. As the Court noted in *McDonald*:

> It is for Congress to determine the relation of campaign expenditures to tax deductions by candidates for public office, under such circumstances and within such limits as commend themselves to its judgment. [323 U.S. at 63].

If deductions are to be allowed for campaign expenses, Congress, not the courts, must so provide.

Accordingly, for the foregoing reasons, defendant's motion for summary judgment is granted and plaintiff's petition is dismissed.

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535 F. 2d 51

JAMES A. MANN, INC. v. THE UNITED STATES

[No. 89–75. Decided May 12, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contract; interpretation.—Plaintiff entered into a fixed-price contract for modernization, painting, converting elevators and providing emergency power of a Federal building. During performance a dispute arose over whether plaintiff was contractually required to furnish an emergency gas-driven power generator. The contract work included elevator repair work, Sec. 14A requiring reuse of existing motor generator sets (electrical devices attached to and placed on top of elevators for purpose of converting alternating current to direct current to operate the elevators). Sec. 16H required the contractor to furnish and install a 200KW natural gas-driven generator of not less than 1197 cubic inches displacement for the emergency power system to be located in the sub-basement. Prior to bid and by Amendment 8 all Sec. 14A elevator work was cancelled. Plaintiff's bid contained the following: "Note: Government to furnish MG equipment according to Spec. 16A–1." Plaintiff has appealed from a decision of the General Services Administration Board of Contract Appeals denying an equitable adjustment for the cost of being required to supply the gas-driven generator. Plaintiff contends that Amendment 8 which eliminated all elevator work and in particular Sec. 14A–23.1 providing that "existing motor generator sets shall be reused" did not remove Sec. 16A–2.2e providing for "installation of M.G. [motor generator] sets and controls supplied by using agency," that this ren-

Syllabus

dered the contract ambiguous since Sec. 16A–2.2e referred to the 200KW gas-driven generator of Sec. 16H, and that the Government was therefore required to furnish the latter rather than plaintiff. It is *held* that plaintiff's interpretation is incorrect and twists the plain meaning of the contract. If plaintiff was confused because 14A–23.1 was removed from the contract by Amendment 8 when 16A–2.2e dealing with the same M.G. sets and controls was not deleted by section number, such confusion was only related to the M.G. sets and controls and had nothing to do with the engine-generator in Sec. 16H. The contract considered as a whole was not ambiguous as to the requirement that plaintiff was obligated to furnish and install a new gas-driven engine-generator, particularly in view of the conduct of the parties and the relevant facts set forth in the opinion. It is also *held* that the note which plaintiff appended to its bid was meaningless and a nullity as far as giving notice of an alleged ambiguity or requesting an explanation of anything in the Invitation for Bids was concerned. The decision of the Board was correct, it was neither arbitrary nor capricious, and was supported by substantial evidence, and is affirmed. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Contracts; interpretation; ambiguity.

[1] An interpretation of a contract which gives a reasonable meaning to all parts of the instrument will be preferred to one which leaves the contract provisions meaningless and the intent of the parties subverted.

Contracts ⟸ 143.5

Contracts; interpretation; ambiguity; clarification, necessity for seeking.

[2] Where a contract provides that a discrepancy either in the drawings or specifications be submitted to the contracting officer for resolution, a contractor who fails to so inquire does so at his own risk.

Contracts ⟸ 143(1)

Contracts; interpretation; ambiguity.

[3] The "contra proferentem" rule that if the language of contract specifications is ambiguous and the contractor's interpretation is reasonable, the ambiguity will be construed against the Government as drafter of the contract, does not apply where the contractor knew of the alleged ambiguity before submitting its bid, thus making it incumbent upon the contractor to seek clarification. The question of whether an ambiguity is patent is *only* relevant where the contractor was not aware of it, and the court is called upon, in retrospect, to decide whether or not the contractor *should have been* aware of it.

United States ⟸ 70(3)

Bernard Glassman for plaintiff. *Erwin Lodge*, attorney of record. *Blank, Rome, Klaus & Company*, of counsel.

Susan M. Linden, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, SKELTON and BENNETT, *Judges*.

SKELTON, *Judge*, delivered the opinion of the court:

This is an appeal by the plaintiff, James A. Mann, Inc., (contractor or plaintiff), from an adverse decision of the General Services Administration Board of Contract Appeals (Board), which decision required the contractor to furnish and install a 200KW natural gas driven engine-generator, which cost $32,867.63, in the Federal Building in Philadelphia, Pennsylvania, under a contract with the Government for "Modernization, Painting, and Emergency Power" of such building. The contractor contended before the Board, and contends here, that the contract terms required the engine-generator to be furnished by the Government, or in the alternative, that the contract was ambiguous in this regard and the ambiguity should be resolved against the Government who drafted the contract, which would require the Government to furnish the engine-generator. As stated above, the Board decided the case in favor of the Government and the contractor appealed to this court under the Wunderlich Act, 41 U.S.C. § 321 (1970) claiming that the decision of the Board was arbitrary, capricious, and not supported by substantial evidence. The case is before us on cross-motions for summary judgment. After reading the pleadings and briefs, hearing oral argument, and reading the entire record of the proceedings before the Board, we hold for the Government and affirm the decision of the Board.

The General Services Administration (GSA) issued invitations for bids (IFB) on December 16, 1971, which contained various sections, some of which are not material here. Sections 14A–1 through 14A–56.2 dealt with elevators. Of those sections, only Section 14A–20 is material to this case. It provided as follows:

14A–20 *Control—Motor Generator Sets*

20.1 Existing motor generator sets shall be reused.

a. Cars #5 & 6: New four stem brush rigging shall be provided on the exciter. New bronze bearings shall be installed. The set shall be disassembled to degree necessary to thoroughly clean and insulate with one coat of insulating varnish. New brushes of manufacturer's recommended grade shall be installed. The commutators on the exciters and generators shall be turned and undercut. A new exciter armature shall be installed on car #5 generator.

b. Cars #9 & 10: Existing motor generator sets shall be reused. The set shall be cleaned and, if necessary, new bearings installed, the commutators turned and undercut. New brushes of manufacturer's recommended grade installed.

Sections 16A–1 through Sections 16A–2e under the heading of General Provisions, provided as follows:

SECTION 16–A

GENERAL PROVISIONS

General

16A–1 *Scope of Work*

1.1 The work covered by this Section of the Specifications consists in furnishing all labor, materials, equipment and accessories and in performing all operations in connection with the installation of the specified material, complete, and in strict accordance with this Section of the Specifications and the applicable Drawings, and subject to the requirements of the "General Provisions," "General Conditions," and "Special Conditions" of this specification.

16A–2 *Work Included*

2.1 Furnish all labor, materials, tools, and other necessary equipment to install complete electrical systems in accordance with the Drawings and Specifications. The reasonable intent of the Drawings and Specifications shall dictate.

2.2 The work to be performed under this Division shall, in general, comprise the following:

a. Service entrance equipment.

b. Complete distribution system for all utilization equipment, including feeders, distribution panelboards, branch circuits, bus duct, and circuit protective devices.

c. Installation of all lighting.

d. Power supply and connection of miscellaneous equipment supplied under this and other Divisions.

e. Installation of M.G. sets & controls supplied by using Agency.

Other specifications material to this case deal with Emergency Elevator Power, Emergency Lighting and the Emergency Power System. So that the pertinent provisions of these specifications may be considered, they are set forth in pertinent parts as follows:

SECTION 16–F

EMERGENCY ELEVATOR POWER

16F–1 *General*

1.1 An Elevator Emergency Power Transfer System shall be provided so that in the event of a reduction to 90% or less of nominal voltage of the normal service and the presence of an emergency service at 90% or more of nominal, the system will automatically permit the operation of two elevators at a time on the emergency service.

1.2 The system shall allow operation of all elevators in any sequence when they are connected to the normal service.

1.3 Upon restoration of all phases of the normal service to 95% or more for an adjustable period of up to 2 minutes maximum, all elevators shall resume normal operation and the elevator connected to the emergency service shall automatically be re-transferred.

1.4 A separate Remote Selector Panels shall be furnished to allow for the selection of two elevators at a time to be operated on the emergency service. Selection of elevators shall be in any sequence and shall not be restricted by equipment design, to a pre-set sequence of selection. The remote selector shall be locked-out of operation when the system is in the normal mode of operation.

1.5 The basic design concept of the system shall be to make emergency power available to a selected elevator without any modification of the elevator controls. There shall be no inter-wiring required between the Elevator Emergency Power Transfer System and the elevator equipment furnished by the elevator manufacturer beyond the connection of the main power conductors.

1.6 The Elevator Emergency Power Transfer System shall be a Bulletin 940–356, as manufactured by the Automatic Switch Company.

* * * * *

16F–3 *Operation*

3.1 Upon normal service failure, control of elevators is transferred to the Remote Selector Panel with all power being derived from the emergency riser.

3.2 When emergency service is available, push-buttons 1 to 4 will light Amber signaling that sequencing of elevators may begin.

3.3 The operator can select any elevator to be connected to the emergency source by pushing the button for that elevator. The color of the light will go from Amber to Red, signaling that the selected elevator is being powered by the emergency service.

3.4 To select another elevator in any sequence, the push-button for the elevator on the emergency service is depressed. The light goes from Red to Amber. The button for the next elevator is then depressed.

3.5 The system is so arranged as to allow two elevators at a time to be connected to the emergency service.

3.6 After the normal service has returned and stabilized, the system will automatically return to normal operation and lock-out the Remote Selector. This is indicated by the Green "N" lamp coming on and remaining lit while the system is in normal operation.

The above Sections 16F–1 through 16F–1.6 and 16F–3 through 16F–3.6 show how at least two of the eleven elevators could be operated from the emergency power system, hereinafter described, if there should be a failure of the regular

electrical supply of energy. Provision was also made for emergency lighting in the building by use of the emergency power system if regular power failed. The emergency lighting provisions were as follows:

SECTION 16–G

EMERGENCY LIGHTING

16G–1 *General*

1.1 The work covered by this Section of the Specifications consists in furnishing all labor, materials, equipment and accessories and in performing all operations in connection with the installation of the specified materials, complete, and in strict accordance with this Section of the Specifications and the applicable Drawings, and subject to the requirements of the "General Provisions," "General Conditions," and "Special Conditions" of this Specification.

16G–2 *Requirements*

2.1 Furnish and install the lighting equipment as shown on the Drawings and specified herein.

2.2 All electric fixtures shall be erected and shall hang perfectly plumb with canopies set squarely against the wall or ceiling, and shall be completely wired with slow burning type of asbestos covered wire, according to NEC rules. Flush mounted recessed fixtures shall be installed so as to completely eliminate light leakage between the frame and the finished surface. Fixture housing, frame or canopy shall provide a suitable cover for the fixture outlet box or fixture opening.

2.3 Contractor shall disconnect existing fixtures, as indicated on drawings, from existing circuits and reconnect on normal/emergency circuits as indicated.

2.4 Contractor shall rewire existing circuit to insure proper operation of lights on remaining existing circuit.

The sections dealing with the emergency power system, with which we are chiefly concerned in this case, required the contractor to *furnish and install* the 200KW gas driven engine-generator that is in controversy here. These sections provided in pertinent part as follows:

Opinion of the Court

SECTION 16-H

EMERGENCY POWER SYSTEM

16H-1 *Engine—Generator*

1.1 *The Electrical Contractor shall furnish and install* a 200 KW, 120/208 volt, three phase, 4 wire, 695 amperes, 0.8 power factor, city water cooled, natural gas driven generator, Pennsylvania approved, as manufactured by Onan, Model 200WC-4R8-31, or similar by Kohler Co., or approved equal.

1.2 The generator and engine shall be direct connected with semi-flexible coupling vibro-mounted on a steel skid base.

1.3 The engine shall be city water cooled, natural gas driven, 6 cylinder, 4 cycle, not less than 1197 cubic inch displacement developing 430 BHP, at a governed speed of 1800 rpm. Mechanical governor shall maintain speed regulation within 5%. Belt-driven governor is not acceptable. It shall include a filter, flow control valve, automatic solenoid shut-off valve, secondary regulator, electric solenoid gas shut-off valve, flexible fuel line, flexible exhaust line, muffler and radio suppression. Starting shall be accomplished by exciter cranking directly connected to the engine crankshaft and capable of withstanding continuous cranking for not less than five minutes. Automotive starting shall not be considered.

1.4 Generator shall be revolving field, direct connected to engine crankshaft with automatic voltage regulation with plus or minus 2%. Generator shall include protection feature to maintain voltage during motor starting. It shall be self-ventilated, of drip-proof construction meeting NEMA, AIEE, and ASA standards for temperature rise.

1.5 The unit shall have a vibro-mounted control panel mounted on exciter frame containing a voltmeter, selector switch, start-stop switch, over-cranking protection arranged to open cranking circuit in 60 to 90 seconds, cranking reset button and automatic two-step battery charging feature.

1.6 A Pennsylvania approved battery charger with an adjustable trickle low charge rate variation

up to 300 milliamperes and high charge rate up to 2 amperes. Charger shall be complete with ammeter, high rate lamps and adjustable rheostat enclosed in NEMA 1 enclosure. Batteries furnished shall be of sufficient capacity to crank engine continuously for at least five minutes at sufficient speed to start engine. Batteries shall be of approved type registered by the State of Pennsylvania.[1] [Emphasis supplied.]

These specifications relating to the engine-generator or any other part of the Emergency Power System were never changed, except by Amendment No. 6 of January 14, 1972, which provided as follows:

Specifications

S-1: Section 16-H, Emergency Power System, Paragraph 16 H-1, Engine Generator, subparagraph 1.1:

a. CHANGE "Onan, Model 200 WC-4R8-31" to read: "Onan, Model 200 FT."

b. ADD new subparagraph to read as follows: "1.1.1 Generator shall be suitable for operation on gas pressure available at the site."

The contractor acknowledged receipt of this amendment in its bid on this contract.

On April 17, 1972, Amendment No. 8 was issued by the contracting officer of the Government. The contractor contends that this amendment created an ambiguity in the contract, which will be discussed below. Amendment No. 8 provided in pertinent part as follows:

S-6: Section 2, Special Conditions:

(a) Paragraph 2-3, BIDS: Delete paragraph in its entirety and substitute in lieu thereof the following:

"2-3 BASE BID

3.1 One lump sum bid is required."

(b) Paragraph 2-4 ALTERNATES: Delete paragraph in its entirety and substitute in lieu thereof the following:

[1] There were two more pages of detailed specifications relating to the Emergency Power System, extending through Sections 16H-3.4, that are not set forth here. However, they are important to show the extent of the system and its vital connection with the whole project, as well as to show the contractor the importance of the system and to alert it as to its duties and obligations with reference thereto.

Opinion of the Court

"2-4 ALTERNATES

4. Alternate prices are required, stating amount to be deducted from the lump sum Bid for making each of the following changes, including all adjustments as required by such changes:[2]

Alternate F for omitting an emergency power system for: The operation of any two elevators; emergency lighting in public corridors and stair halls; minimum operation of essential mechanical equipment, including water and sewage ejector pumps.

Note: No elevator work, except as described in Alternate F and Section 16-F, EMERGENCY ELEVATOR POWER, is to be performed under this contract.

4.2. The lump sum Bid reflects the desired requirements for the project as shown and specified. Alternates provide for certain omissions or substitutions at the option of the Government. Any award which includes Alternates will be made on the basis of the lowest aggregate bid resulting from the amount of the lump sum Bid less the amount of the Alternate or Alternates as may be accepted by the Government. The Government reserves the right to accept or reject any and all alternate prices as may be determined by the Contracting Officer to be in the best interest of the Government.

S-7: Section 14A, Elevators:

Delete section in its entirety and substitute in lieu thereof the following:

"Section 14A not used."

The IFB also required each bidder to submit a list showing the name and address of the firm to whom he proposed to subcontract each of the categories of work listed in the bid form, in pertinent part as follows:

2.25. *Listing of Subcontractors*

25.1 For each of the categories of work contained in the list included as part of the Bid Form, the bidder shall submit the name and addresses

[2] Alternates A, B, C, D, and E set forth in the Amendment are not involved in this case.

of the firm to whom he proposes to subcontract the work.

Plaintiff submitted its bid on May 2, 1972, for a lump sum of $1,247,000, without any alternates, and also with six alternate bids (A, B, C, D, E, & F) whereby plaintiff proposed to deduct the amount specified for nonperforming each alternate, respectively, from the lump sum bid should the Government exercise its option to accept any or all of the alternate proposals. The plaintiff's bid was in pertinent part as follows:

> In compliance with the above-dated invitation for bids, the undersigned hereby proposes to perform all work for modernization, painting and emergency power at the Federal Building, 225 South 18th Street, Philadelphia, Pennsylvania in strict accordance with the General Provisions (Standard Form 23–A), Labor Standards Provisions Applicable to Contracts in Excess of $2,000 (Standard Form 19–A), specifications, schedules, drawings, and conditions, for the following amount:
>
> *One million two hundred forty seven thousand and 00/100* Dollars (*$1,247,000.00*)
>
> * * * * *
>
> *DEDUCT ALTERNATE F* for omitting all work relating to providing an emergency power system for the operation of any two elevators; emergency lighting in public corridors and stair halls; minimum operation of essential mechanical equipment, including water and sewage ejector pumps as specified in Section 2, SPECIAL CONDITIONS, paragraph 4, ALTERNATES, and in Section 16–F, EMERGENCY ELEVATOR POWER, Section 16–G, EMERGENCY LIGHTING and Section 16–H, EMERGENCY POWER SYSTEM:
>
> *One hundred four thousand and 00/100* Dollars (*$104,000.*)
>
> * * * * *
>
> Note: Government to furnish MG equipment according to Spec. 16A–1.
>
> Elevator operator to be provided by owner according to Spec.

Attached to plaintiff's bid was a list of subcontractors and their addresses to whom it expected to subcontract the various phases of the work. This list showed that it expected to

subcontract to Seaboard Elec. Co., 1913 Wharton Road, Jenkentown, Pennsylvania, all of the work in the following categories:

SECTION 16–F
EMERGENCY ELEVATOR POWER

SECTION 16–G
EMERGENCY LIGHTING

SECTION 16–H
EMERGENCY POWER SYSTEM

The bids were opened on May 2, 1972, the same day plaintiff submitted its bid. The plaintiff was second lowest bidder, but was advised by letter dated June 1, 1972, that its lump sum bid of $1,247,000 had been accepted (without alternates).[3] The letter contained the following notation:

> Liq. damages in spec.: $115 per c.d. for all work *except emergency power system shall be $50 per c.d.* [Emphasis supplied.]

A notice to proceed was issued by the Government for work to begin on the contract on July 6, 1972. During the first part of August 1972, the plaintiff took the position that by reason of Amendment No. 8, which eliminated all elevator work from the contract as set forth in Section 14A and in particular Section 14A–23.1 that provided:

> Existing motor generator sets shall be reused

but did not remove Section 16A–2.2e which provided for the following work:

> Installation of M.G. [motor generator] sets and controls supplied by using agency

caused the contract to be ambiguous and that Section 16A–2.2e referred to the gas driven engine—200KW generator in Section 16H, and, therefore, the Government was required to furnish it instead of the plaintiff. The plaintiff said further that it called this ambiguity to the attention of the contracting officer by its note written on its bid (quoted above). During the performance of the contract the plaintiff asked the contracting officer for a decision on this question, which was

[3] The low bidder was disqualified.

made by the contracting officer adverse to the position of the plaintiff, and it was ordered by the contracting officer to furnish and install the engine-generator as required by Section 16H. The contractor appealed to the Board, which, after an evidentiary hearing in which the contractor participated, rendered a decision holding that the contract and the facts required the contractor to furnish and install the engine-generator. The plaintiff then filed this suit in which it takes the same position it took with the contracting officer and the Board and makes the same arguments it previously made, as stated above.

We think that the plaintiff is clearly wrong and is twisting the plain meaning of the contract with reference to its obligation to furnish and install the engine-generator in such a way that the contract provisions are meaningless and the intent of the parties is subverted. There was no connection between the "M. G. sets and controls" in Sections 14A–23.1 and 16A–2.2e on the one hand and the "engine-generator" in 16H on the other. If the plaintiff was confused because 14A–23.1 was removed from the contract by Amendment No. 8 when 16A–2.2e that dealt with the same M.G. sets and controls was not deleted by section number, such confusion was only related to the M.G. sets and controls and had nothing whatever to do with the engine-generator in Section 16H. The plaintiff was not called on to furnish M.G. sets and controls and its argument about them is irrelevant and meaningless as far as its obligation to furnish and install the engine-generator is concerned. There is no basis for plaintiff to try to confuse M.G. sets and controls with the engine-generator, because they are entirely different. The evidence of two engineers at the Board hearing showed that M.G. sets were electrical devices that were attached to and placed on top of the eleven elevators in the building for the purpose of converting alternating electric current to direct current to operate the elevators. On the other hand, the engine-generator was described in the contract as a 200KW, 120/208 volt, three phase, 4 wire, 695 amperes, 0.8 power factor, city water cooled, natural gas driven generator, 6 cylinder, 4 cycle, not less than 1197 cubic inch displacement, developing 430 BHP at a governed speed of 1800 RPM, etc. (See Sec. 16H–1 to 16H–1.5 quoted in full above.) Any qualified engineer or electrician

would know the difference between such an engine and M.G. sets and controls. It is obvious that the plaintiff did also.

Furthermore, plaintiff was on notice by Section 14A–20.1, quoted above, that some of the existing motor generator sets were on elevator cars 5, 6, 9, and 10. It was further on notice by Sections 14A–22.1 and 14A–23 that some of the existing controllers were on elevator cars 5, 6, 9, and 10, and that the purpose of the controllers on cars 5 and 6 was to control "starting, stopping and the speed of the *elevator motor* and also to automatically apply the brake." (Emphasis supplied.) It can be assumed that the controllers on the other elevator cars performed the same functions. In any event, the indicated specifications informed the plaintiff as to the location and functions of the motor generator sets and controllers.

On the other hand, Section 16H described the gas driven 200KW engine-generator in great detail. It was obviously a heavy piece of equipment and *was to be located in the sub-basement*, as shown on Drawing 9–E–21. The plaintiff was on notice as to these facts.

Anyone, whether he be a competent engineer or electrician, or even a school boy, would know from these facts that the elevator motor generator sets and controls on the elevators were not the same as the gas driven 200KW engine-generator in the sub-basement of the building. The argument of the plaintiff that Section 16A–2.2e provides "Installation of M.G. sets and controls supplied by using agency" refers to the gas driven 200KW engine-generator is patently absurd.

All of the facts show that the plaintiff knew it was required to furnish and install the engine-generator and that it actually expected to do so when it made its bid and signed the contract. These facts may be listed as follows:

(1) The IFB (Sec. 16–1.1) stated in plain and unequivocal language that—

> *The electrical Contractor shall furnish and install* a 200KW * * * natural gas driven generator * * *. [Emphasis supplied.]

This requirement was never changed.

(2) Amendment No. 8 required the plaintiff to submit an alternate bid (Alternate F) showing the amount it would deduct from its lump sum bid if the Government omitted

from the contract the provisions of the emergency power system.

(3) The plaintiff submitted alternate bid F in which it proposed to deduct $104,000 from its lump sum bid if the Government would omit the emergency power system as specified in Sec. 16F (Emergency Elevator Power), Sec. 16–G (Emergency Lighting), and Sec. 16–H (Emergency Power System).[4] The Government declined to exercise its option to delete these sections from the contract. Consequently, plaintiff was well aware that it was required by the contract to furnish and install the engine-generator and to do the other work required by these sections.

(4) The plaintiff attached to its bid the name and address of the subcontractor (Seaboard Elec. Co.) who would do the work required by Sections 16–F, 16–G and 16–H of the contract, showing that it well knew it would have to comply with the requirements of these sections.

(5) The letter from the Government of June 1, 1972, notifying plaintiff it had been awarded the contract contained a notation that liquidated damages for the power system would be "$50 per c.d." The plaintiff signed the contract with knowledge of this notation.

(6) The contract that the plaintiff signed on June 1, 1972, provided in pertinent part as follows:

> The United States of America (hereinafter called the Government), represented by the Contracting Officer executing this contract, and the individual, partnership, joint venture, or corporation named above (hereinafter called the Contractor), mutually agree to perform this contract in strict accordance with the General Provisions (Standard Form 23–A), Labor Standards Provisions Applicable to Contracts in Excess of $2,000 (Standard Form 19–A), and the following designated specifications, schedules, drawings, and conditions: Specification for Modernization, Painting, and Emergency Power, Federal Building, 225 South 18th Street, Philadelphia, Pennsylvania dated December 16, 1971 and Amendments Nos. 1, 2, 3, 4, 5, 6, 7, and 8 thereto dated

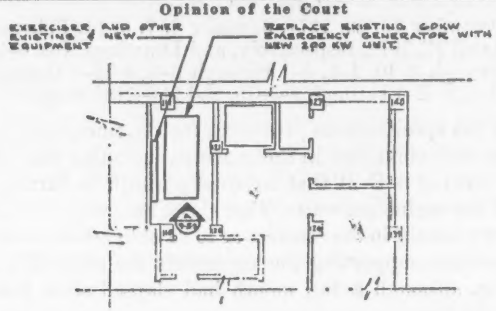
[4] Alternate F is quoted in full above.

December 16, 29, 1971, January 4, 7, 6, 14, February 4, April 17, 1972, respectively, and Drawings Nos. 0–1, 3–1 through 3–40, 4–1, 5–1 through 5–5, 9–H–1 through 9–H–8, 9–E–1 through 9–4–18, and 9–4–21 through 9–4–35.

All of the specifications providing for the emergency power system were contained in the contract, including Sec. 16H–1 and Drawing 9–E–21 that required plaintiff to furnish and install the engine-generator. There is no reservation or exception by plaintiff in the contract as to its obligations under the contract nor supporting the arguments the plaintiff is now making, although a full month had elapsed since plaintiff made its bid.

(7) The plaintiff never sought to withdraw its bid or make any changes in the bid nor did it request the Government to make any changes in the contract because of what it now claims were ambiguities in the IFB, although it had a full month in which to do so.

(8) A drawing or map (9–E–21) which was attached to the IFB and which is listed in the contract quoted above, (and which was introduced into evidence at the Board hearing), shows the location of the then existing 60KW emergency generator in the sub-basement. The map bears the notation "*Replace* existing 60KW emergency generator with new 200KW unit." (Emphasis supplied.) This is proof that the plaintiff was on notice that it had to furnish and install a new 200KW generator as required by Sec. 16H–1 of the contract to replace the old 60KW generator in the sub-basement. The drawing is further proof, which was not disputed, that the Government did not possess an old 200KW generator in the building that it could furnish to plaintiff to be reused, as plaintiff now contends is the meaning of Sec. 16A–2.2e where it is recited "Installation of M.G. sets and controls supplied by agency." Such a contention is unreasonable. To confuse M.G. sets and controls (plural) that are located on top of the eleven elevators (in a *used* condition) with *one new* 200KW engine-generator to replace the old 60KW generator in the sub-basement is like confusing cats with dogs or apples with oranges. The pertinent portion of drawing 9–E–21 is as follows:


EXERCISER AND OTHER EXISTING & NEW EQUIPMENT
REPLACE EXISTING 60KW EMERGENCY GENERATOR WITH NEW 200 KW UNIT
PARTIAL SUB-BASEMENT PLAN
SCALE 1/8" = 1'-0"

Plaintiff's present position is no doubt an afterthought, as it is inconsistent with its acts and conduct prior to and up to the time its bid was submitted.

We hold that the contract considered as a whole was not ambiguous as to the requirement that plaintiff was obligated to furnish and install a new gas driven engine-200KW generator, and this is especially true in view of the conduct of the parties and the relevant facts described in the foregoing paragraphs.

As stated above, the plaintiff has complained that the contract is ambiguous because Amendment No. 8 removed Section 14A–20.1 from the contract which provided that "existing motor generator sets shall be reused" but did not remove Section 16A–2.2e which provided "installation of M.G. sets and controls supplied by using agency," which remained in the contract. In the first place, Sec. 16A–2.2e was effectively removed from the contract, although not by section number description, by the following provision of Amendment No. 8:

> *No elevator work*, except as described in Alternate F and Section 16–F, EMERGENCY ELEVATOR POWER, *is to be performed under this contract.* [Emphasis supplied.]

The installation of M.G. sets and controls was clearly elevator work. Therefore, Sec. 16A–2.2e was deleted from the

contract along with Sec. 14A–20.1 by this general language. Further proof of this deletion is the fact that the plaintiff did not install any M.G. sets and controls on the elevators, nor was it required to do so in the performance of the contract.

In the next place, if there was any ambiguity in the contract it was with reference to the sections last above described, which did no harm to plaintiff nor caused any loss to it, because it was not required to install any M.G. sets and controls and did not do so. Therefore, the alleged ambiguity, even if it existed, and we do not think it did, was immaterial and irrelevant to any issue in this case.

Furthermore, the alleged ambiguity was well known to plaintiff before it filed its bid. The plaintiff admits this to be true and says that is the reason it appended the note to its bid. In following this procedure, the plaintiff did not comply with the provisions of the IFB, which was a part of the Federal Procurement Regulations, FPRI–16.901–22, which provided as follows:

> 1. *Explanations to Bidders.* Any explanation desired by a bidder regarding the meaning or interpretation of the invitation for bids, drawings, specifications, etc., must be requested in writing and with sufficient time allowed for a reply to reach bidders before the submission of their bids. Any interpretation made will be in the form of an amendment of the invitation for bids, drawings, specifications, etc., and will be furnished to all prospective bidders. Its receipt by the bidder must be acknowledged in the space provided on the Bid Form (Standard Form 21) or by letter or telegram received before the time set for opening of bids. Oral explanations or instructions given before the award of the contract will not be binding.

It is clear from this provision that if the plaintiff had any question about any part of the IFB or desired any explanation as to its provisions it was required to request an interpretation or explanation in writing with sufficient time for a reply to reach all bidders *before* the submission of their bids. The plaintiff did not do this. The note on its bid did not comply with this requirement. Consequently, plaintiff is in no position to complain.

Furthermore, the contract provided that if there was any discrepancy in the figures, drawings, or specifications, the matter shall be submitted to the contracting officer, who shall make a reply in writing. This provision of the contract was as follows:

> 2. SPECIFICATIONS AND DRAWINGS
>
> The Contractor shall keep on the work a copy of the drawings and specifications and shall at all times give the Contracting Officer access thereto. Anything mentioned in the specifications and not shown on the drawings, or shown on the drawings and not mentioned in the specifications, shall be of like effect as if shown or mentioned in both. In case of difference between drawings and specifications, the specifications shall govern. In case of discrepancy either in the figures, in the drawings, or in the specifications, the matter shall be promptly submitted to the Contracting Officer, who shall promptly make a determination in writing. Any adjustment by the Contractor without such a determination shall be at his own risk and expense. The Contracting Officer shall furnish from time to time such detail drawings and other information as he may consider necessary, unless otherwise provided.

Obviously, the plaintiff did not comply with this requirement of its contract. As stated above, without complying with this provision, the contractor proceeds "at his own risk and expense." *See Black, Raber-Kief & Associates* v. *United States*, 174 Ct. Cl. 302, 308, 357 F. 2d 355, 358 (1966); *Jefferson Construction Co.* v. *United States*, 176 Ct. Cl. 1363, 1369, 364 F. 2d 420, 423–24 (1966), *cert. denied*, 386 U.S. 914 (1967); *J. A. Jones Construction Co.* v. *United States*, 184 Ct. Cl. 1, 11–12, 395 F. 2d 783, 789–90 (1968); and *HRH Construction Corp.* v. *United States*, 192 Ct. Cl. 912, 920, 428 F. 2d 1267, 1272 (1970).

Plaintiff contends that the contract was ambiguous and that under the "contra proferentem" rule all doubts should be resolved against the Government who drafted the contract and plaintiff's interpretation should be adopted, because it is reasonable. While this rule is well established, it does not apply in this case where the plaintiff knew of the alleged ambiguity *before* it submitted its bid. Under these circumstances it was incumbent on the contractor to bring the matter

to the attention of the Government. The correct rule is stated in *Beacon Construction Co.* v. *United States*, 161 Ct. Cl. 1, 6–7, 314 F. 2d 501, 504 (1963) as follows:

> * * * The bidder who is on notice of an incipient problem, but neglects to solve it as he is directed to do by this form of contractual preventive-hygiene, cannot rely on the principle that ambiguities in contracts written by the Government are held against the drafter (*e.g.*, *Peter Kiewit Sons' Co.* v. *United States*, 109 Ct. Cl. 390, 418 (1947)). Even more, the bidder in such a case is under an affirmative obligation. He "should call attention to an obvious omission in a specification, and make certain that the omission was deliberate, if he intends to take advantage of it." *Ring Construction Corp* v. *United States*, 142 Ct. Cl. 731, 734, 162 F. Supp. 190, 192 (1958). See also, to the same effect, *Jefferson Constr. Co.* v. *United States*, 151 Ct. Cl. 75, 89–91 (1960). * * *

Plaintiff argues that *Beacon* is not applicable to its situation. It asserts that the ambiguity in *Beacon* was "patently obvious" while the alleged ambiguity in the present case was "not glaring." This distinction, even assuming it to be valid, is irrelevant. The question of whether an ambiguity is patent is *only* relevant where the contractor was not aware of it, and the court is called upon, in retrospect, to decide whether or not he *should have been* aware of it. *See Jack Stone Co.* v. *United States*, 170 Ct. Cl. 281, 289–290, 344 F. 2d 370, 375 (1965); *Blount Brothers Construction Co.* v. *United States*, 171 Ct. Cl. 478, 346 F. 2d 962 (1965); *Tufano Contracting Corp.* v. *United States*, 174 Ct. Cl. 398, 407, 356 F. 2d 535, 540 (1966); *Boyajian* v. *United States*, 191 Ct. Cl. 233, 260, 423 F. 2d 1231, 1247 (1970). It is clear in this case that the alleged ambiguity was known to the plaintiff before it submitted its bid. Its president admitted this to be true. Having this knowledge, plaintiff was required to seek clarification from the contracting officer. This it failed to do.

Plaintiff argues that the note on its bid was notice to the contracting officer that there was an ambiguity in the IFB and that this complied with the requirements of the IFB and of FPR 1–16.901–22. We do not agree. The note did not give notice of anything. It did not mention ambiguity, conflict,

confusion nor ask any question; it did not request an explanation or interpretation of any of the provisions of the IFB. The note did not mention the 200KW gas driven engine-generator required to be furnished by Sec. 16H–1.1 and Drawing 9–E–21 with which we are concerned here, but referred to Sec. 16A–1 which was a general provision that had no bearing on the question and was meaningless as far as the present controversy is concerned. The note used the "M.G." language of 16A–2.2e with reference to work that had been deleted by Amendment No. 8. The contracting officer reasonably concluded that the note was not notice of anything and that it did not call for any action on his part. The contracting officer stated:

> The language of the statement in [plaintiff's] bid is almost identical to the language contained in paragraph 16A–2.2e. Therefore, in this instance, I cannot see where repeating a statement which is contained in the contract specification could be considered a qualification to [plaintiff's] bid.

A comparison of the two phrases, "Installation of M.G. sets and controls supplied by using Agency" (Sec. 16A–2.2e) and "Government to furnish mg equipment according to Spec. 16A–1" (plaintiff's note) supports his interpretation of plaintiff's note.[5] We conclude that the note was meaningless and a nullity as far as giving notice of an alleged ambiguity or requesting an explanation of anything in the IFB was concerned. Having failed to give notice of the alleged ambiguity before bidding, as required by the contract and FPR 1–16.901–22, the plaintiff is legally precluded from recovering the cost of the engine-generator from the Government on the basis of the alleged ambiguity. *See Anthony Grace & Sons, Inc.*, v. *United States*, 193 Ct. Cl. 248, 433 F. 2d 766 (1970); and *Consolidated Engineering Co.* v. *United States*, 98 Ct. Cl. 256 (1943).

The Board found that the plaintiff did not meet its burden to call the Government's attention to the alleged ambiguity. The Board found further that the plaintiff did not present

[5] The contracting officer's interpretation is also supported by the other "note" to plaintiff's bid; "ELEVATOR OPERATOR TO BE PROVIDED BY OWNER ACCORDING TO SPEC," is, similarly, merely a restatement of another existing specification provision.

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any evidence that it made any reduction in its bid price because of the alleged ambiguity. In fact, plaintiff's Alternate F bid, in which it offered to deduct $104,000 from its lump sum bid of $1,247,000 if the Emergency Power System described in Sections 16F, 16G and 16H was omitted from the contract, is convincing evidence that the cost of the 200KW engine-generator, which Section 16H.1 required the plaintiff to furnish and install, was included in its lump sum bid. We think these findings of the Board were correct. Under these circumstances, a judgment against the Government in this case would amount to a windfall for the plaintiff. This would be unjust to the Government, as well as unfair to the other bidders.

We hold that the decision of the Board was correct, that it was neither arbitrary nor capricious and was supported by substantial evidence and should be affirmed.

Therefore, the decision of the Board is affirmed. Plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, and plaintiff's petition is dismissed.

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535 F. 2d 1225

CATAPHOTE CORPORATION OF MISSISSIPPI

v.

THE UNITED STATES

[No. 103–73. Decided May 12, 1976]

OPINION

Taxes; income tax; accumulated earnings tax.—Plaintiff seeks refund of accumulated earnings taxes paid for fiscal years ended June 30, 1968 and 1969. Plaintiff is an affiliate of an Ohio corporation, without separate premises, whose stock was owned almost entirely by the Searight family, including Charles Searight, plaintiff's sole stockholder. During the years in suit plaintiff's business was the leasing of trucks from a national rental company on a full service and maintenance basis and in turn subleasing them to Ohio for transportation of Ohio's products from its plant in Mississippi, to customers throughout the country at common carrier rates with Ohio's employees as drivers. In lieu of dividends plaintiff made loans to Charles Searight for his personal and speculative needs, in addition to payments of salary and deferred compensation. Plaintiff

claims that the earnings were accumulated to meet anticipated business needs, such as the cost of purchasing trucks and constructing a service facility, for working capital, and for additional financing of its participations in oil and gas businesses. On the basis of the evidence it is concluded that plaintiff's business was primarily that of diverting to Charles Searight and plaintiff additional compensation which would otherwise not have been deductible by Ohio; that at most the purchase of vehicles and facilities was merely a possibility discussed over a period of years but never sufficiently definite or likely to justify accumulation of earnings; that on the basis of the Bardahl operating-cycle test plaintiff's accumulation of earnings was excessive to meet its working capital needs; and that plaintiff's participation in minority interests in oil drilling ventures was not a business but merely a series of investments or speculations unrelated to its business. It is *held* that plaintiff's accumulations of earnings and profit were beyond the reasonable needs of its business and that plaintiff was availed of for purpose of avoiding income taxes with respect to its sole stockholder by permitting its earnings and profits to accumulate instead of being distributed. It is also *held* that an accumulated earnings tax is within the scope of Sec. 51(a)(1)(B) of the Code levying an additional income tax equal to a percentage of the "adjusted tax" for certain years; in addition, plaintiff is barred from raising this issue since it did not raise it during the administrative proceedings. Plaintiff is not entitled to recover and the petition is dismissed.

Taxes; income tax; accumulated earnings tax; tax avoidance; dominant motive.

[1] In applying Secs. 531–537 of the Internal Revenue Code of 1954 imposing a tax on accumulated taxable income of every corporation formed or availed of for the purpose of avoiding income tax with respect to its shareholders, the forbidden purpose need not be the sole, dominant, controlling or impelling motive; it is sufficient if it is one of the motives for the accumulation.

Internal Revenue ⟸ 763.2

Taxes; income tax; accumulated earnings tax; reasonable needs of the business.

[2] In determining whether or not corporate profits were accumulated for the "reasonably anticipated needs" of the business rather than to avoid income tax on dividends to shareholders, the corporate taxpayer's claimed intention must be manifested by some contemporaneous course of conduct directed toward the claimed purpose.

Internal Revenue ⟸ 763.1

Taxes; income tax; accumulated earnings tax; reasonable needs of the business.

[3] While the accumulation of corporate earnings is permitted for working capital needs of an existing business, to the extent that

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the payment of expenses may be postponed as a result of credit arrangements, the need for operating capital is reduced.

Internal Revenue ⇐ 763.3

Taxes; income tax; accumulated earnings tax; unrelated investment activities.

[4] The investing of earnings is not necessarily inconsistent with the retention of earnings to meet anticipated needs of the business, but investing in minority interests in oil drilling ventures operated and managed by others is not a business need in itself which can justify the accumulation of earnings.

Internal Revenue ⇐ 763.3

Taxes; income tax; accumulated earnings tax; reasonable needs of the business; unrelated investment activities; net liquidation value.

[5] In computing whether accumulated earnings and profits are beyond the reasonable needs of the business, investments in silver bullion must be valued at their depreciated market value rather than original cost.

Internal Revenue ⇐ 763.3

Taxes; income tax; accumulated earnings tax; reasonable needs of the business.

[6] Substantial loans to a sole corporate stockholder in the absence of dividends are incompatible with a purpose to strengthen the financial operation of the corporation but accord with a desire to get the equivalent of the controlling stockholder's dividends under another guise.

Internal Revenue ⇐ 763.3

Taxes; income tax; surcharge; accumulated earnings tax.

[7] The accumulated earnings tax is within the term "adjusted tax" of Sec. 51(a)(1)(B) of the Code levying a tax surcharge on the income of corporations equal to 10% of the adjusted tax, absent congressional intent to exempt accumulated earnings tax from taxes imposed by Chapter 1 of the Code.

Internal Revenue ⇐ 763.1

Taxes; civil actions or suits for refund of taxes; claim for refund; necessity for filing.

[8] Taxpayer's failure to raise the contention in its administrative claim for refund that the accumulated earnings tax is not within the term "adjusted tax" of Sec. 51(a)(1)(B) of the Code bars its consideration by this court.

Internal Revenue ⇐ 1964

Jack Rephan, attorney of record, for plaintiff. *David J. Harris*, *Harry L. Hickson*, *Smith*, *Cohen*, *Ringel*, *Kohler*, *Martin & Lowe* and *Danzansky*, *Dickey*, *Tydings*, *Quint & Gordon*, of counsel.

William Kalish, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

Before COWEN, *Chief Judge*, NICHOLS and KUNZIG, *Judges*.

PER CURIAM: This case comes before the court on defendant's motion, filed February 4, 1976, for judgment, moving that the court adopt, as the basis for its judgment in this case, the recommended decision of Trial Judge Philip R. Miller, filed October 9, 1975, pursuant to Rule 134(h), defendant having filed no notice of intention to except thereto and plaintiff, on January 30, 1976, having withdrawn its previously filed notice of intention to except thereto. Upon consideration thereof, without oral argument, since the court agrees with the recommended decision, as hereinafter set forth,* it hereby grants defendant's motion and affirms and adopts the decision as the basis for its judgment in this case. Therefore, it is concluded that plaintiff is not entitled to recover and plaintiff's petition is dismissed.

OPINION OF TRIAL JUDGE

MILLER, *Trial Judge:* Sections 531 and 532 of the Internal Revenue Code impose the accumulated earnings tax upon the accumulated taxable income of every corporation formed or availed of for the purpose of avoiding the income tax with respect to its shareholders by permitting earnings and profits to accumulate instead of being divided or distributed. Section 533 provides that the fact that the earnings and profits are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders, unless the corporation by the preponderance of the evidence shall prove to the contrary.

The purpose of this statute has been simply put in a recent Supreme Court decision (*Ivan Allen Co.* v. *United States*, 422 U.S. 617, 624–25 (1975)):

*Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed October 9, 1975, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

Opinion of Trial Judge

> Because of the disparity between the corporate tax rates and the higher gradations of the rates on individuals, a corporation may be utilized to reduce significantly its shareholders' overall tax liability by accumulating earnings beyond the reasonable needs of the business. * * *
>
> In order to foreclose this possibility of using the corporation as a means of avoiding the income tax on dividends to the shareholders, every Revenue Act since the adoption of the Sixteenth Amendment in 1913 has imposed a tax upon unnecessary accumulations of corporate earnings effected for the purpose of insulating shareholders. [Footnotes omitted.]

In the application of the statute the forbidden purpose need not be the sole, dominant, controlling, or impelling motive; it is sufficient if it is one of the motives for the accumulation. *United States* v. *Donruss Co.*, 393 U.S. 297 (1969).

Plaintiff having been subjected to the assessment and payments of such taxes in the sums of $32,217 and $19,849 for its fiscal years ended June 30, 1968 and 1969, respectively (hereinafter 1968 and 1969), it now sues for their refund.

Cataphote Corporation of Mississippi (Mississippi or plaintiff) is an affiliate of Cataphote Corporation of Ohio (Ohio). During the taxable years in issue Ohio was engaged in the manufacture and sale of glass beads, plastics, paints and other traffic control equipment. The stock of Ohio was owned almost entirely by the Searight family. William Searight, the head of the family, who in 1968 was 76 years of age, held 42 percent in his own name and proxies for 23 percent more owned by his daughter. His son, Charles Searight, held 15 percent in his own name and another 15 percent as custodian for his children. The remaining 5 percent was owned by the daughter's children. William Searight was chairman of the board and chief executive officer, while Charles was president.

At the same time Charles was sole stockholder and president of plaintiff; William, who owned no stock in plaintiff, was vice-president; and Bob J. Young, who owned no stock in either corporation but was plant accountant, purchasing agent and traffic manager for Ohio, was secretary-treasurer of plaintiff.

It was Mississippi's business or function to lease trucks from Ryder Truck Rental, Inc., of Jackson, Mississippi, a national leasing organization, under a contract for full service and maintenance by Ryder, and in turn sublease them to Ohio for the transportation of some finished merchandise from Ohio's manufacturing plant in Jackson, Mississippi (where 95 percent of its shipments originated) to its customers throughout the country, and also for the transportation of some raw materials from Ohio's suppliers to its plant. Mississippi had no employees other than its officers mentioned above, nor separate premises.

Under the prime lease Ryder provided maintenance, repairs, parts, fuel, oil, lubricants, tires, and all other operating supplies and accessories in return for a flat charge per mile with a minimum requirement of 130,000 miles use per vehicle per year. The lease was for a 3-year term with the right in either party to terminate a vehicle after 1 year. In the event of such termination by plaintiff it had the obligation to purchase the vehicle at the original value less accrued scheduled depreciation. The lease was renewed by plaintiff at 3-year intervals with new vehicles and was last renewed for the period May 1969 to 1972 when it covered six vehicles. The contemporaneous sublease from plaintiff to Ohio was substantially the same, except for the method and rate of compensation. It was not measured by the operating mileage but was either an amount equal to the minimum rail freight charges (where Ohio had the option to ship by rail), or the lowest commodity or other commercial freight rate, whichever was smaller; and with respect to incoming shipments priced on a delivered basis, was equal to the actual freight charges allowed by the supplier.

The sublease did not prescribe the full terms of the arrangement between Ohio and Mississippi, however. Even though the truck drivers were employees of Ohio, Mississippi bore the economic burden of their wages. Plaintiff billed Ohio pursuant to the terms of the sublease but Ohio offset the billing by the amounts it had paid the truck drivers on a round-trip mileage basis and for employment taxes and insurance on the drivers. Such offsets were approximately $117,000 for 1968 and $109,000 for 1969. On the other hand, although the

trucks were subleased to Ohio, Mississippi was entitled to the entire proceeds of carrying loads for third persons on the return trips. Plaintiff earned $31,371 on backhaul revenues from third persons for 1968 and $40,209 for 1969.

The sublease arrangement did not cover all of Ohio's shipping requirements but only those shipments which Mississippi chose to accept, representing about 50 percent of Ohio's needs. The election was purely up to plaintiff. If the common carrier rate for a particular trip which Mississippi was required to match was not sufficiently high to return a suitable profit to plaintiff, Ohio had to find a common carrier. On the other hand, where the commercial rates were higher, or where plaintiff was able to negotiate a return load for its own benefit to enhance its profit, it would elect to allow Ohio to use the leased equipment for that trip. Since the charge was the same whether plaintiff or a common carrier handled the load, it made no difference to Ohio as to which was used.

Charles Searight's duties in connection with plaintiff's trucking operations involved the selection of the trucking equipment to be rented from Ryder, negotiating the Ryder lease, renting additional trucks in peak season, assuring Ryder's carrying out its maintenance and repair obligations, ascertaining which of Ohio's loads were available and deciding which ones the trucks should carry, and organizing backhauls by telephone through brokers at the destinations. Young assisted him in this regard and in addition kept the books. The line between their duties for plaintiff and for Ohio was somewhat unclear. It was sometimes difficult for either of them to know when he was working for Mississippi and when he was working for Ohio. It necessitated a legal conclusion rather than a factual determination. Indeed there is a conflict between the testimony of Charles Searight and Young, the former stating that his supervision of the drivers was in his capacity as president of Ohio and the latter understanding that his supervisory duties as subordinate to Searight were on behalf of plaintiff, rather than as traffic manager of Ohio. Furthermore, when either had to decide whether to route a particular shipment via leased trucks with drivers paid by Ohio and reimbursed by Mississippi, or by

common carrier, it was obviously difficult to know when his duties for plaintiff began and those for Ohio ended.

The entire space plaintiff occupied was the one-room office on the premises of Ohio's plant, which also served as Charles Searight's and Young's office as employees of Ohio. Plaintiff paid neither rent, compensation for the use of its secretarial help, nor reimbursement for local or long distance telephone bills, although Ohio's telephone was used to negotiate the backhauls from distant destinations for plaintiff's exclusive benefit.

The amorphous nature of the relationship between the two corporations is epitomized by the fact that the sublease between Mississippi and Ohio was signed *for Ohio* by Charles Searight, who was president and sole stockholder of plaintiff, and for Mississippi by Young, who had no proprietary interest in plaintiff but was principally employed by Ohio.

In addition to a $60,000 annual salary from Ohio, Charles Searight received from Mississippi for 1968, $25,884 and for 1969, $43,754 in salary and deferred compensation under pension or profit-sharing plans.[1] William Searight, his father, also received $5,040 per year as vice president of plaintiff in addition to his salary as chairman of the board and chief executive officer of Ohio. Young received from Mississippi in salary and deferred compensation $25,135 for 1968 and $25,865 for 1969. The record does not reflect Young's compensation from Ohio.

It is difficult to comprehend what business purpose of Ohio's was served by the entire arrangement with plaintiff, since the election as to the loads to be carried in the leased trucks was decided only with reference to benefit to plaintiff and Ohio was not entitled to any transportation rates lower than what it would have had to pay common carriers in any event for such loads. It is also difficult to understand what business purpose of Ohio's was served by leasing the trucks from plaintiff as a middleman rather than directly from Ryder. Plaintiff absorbed very little if any of the risks, since the amounts it owed Ryder and the net amounts Ohio

[1] The record does not reflect the amount of deferred compensation paid by Ohio.

owed it were necessarily correlated because both were based on actual use. Plaintiff incurred no substantial obligation to Ryder which was not at the least offset by a corresponding obligation to it from Ohio, and plaintiff could even ensure this by choosing only such of Ohio's shipments as would give it the most profitable round trip.[2] Ohio also lost the benefits of all of the backhaul revenues from third persons, while it absorbed the long-distance telephone and other administrative costs of carrying on that portion of the business. It is fair to conclude that in any arm's-length dealings Ohio could have obtained the same service from Charles Searight, its president, for far less than the approximately $250,000 in salary and net profits from trucking (after taxes) he and his wholly owned corporation earned for the 2 years, 1968 and 1969, in addition to his $120,000 in salary from Ohio.

The only reasonable inference to be drawn from these facts is that the business of Mississippi was primarily that of diverting or channeling off to Charles Searight and his wholly owned corporation additional compensation, which would otherwise not have been deductible from its income by Ohio.

The foregoing description of plaintiff's business is important. The statute allows the accumulation of earnings for the reasonable needs of the business and makes presumptively determinative of the purpose to avoid income tax with respect to the shareholder only the accumulation of earnings beyond the reasonable needs of the business. Thus, we are put to the duty of ascertaining what is the business of the taxpayer in order to determine its reasonable business needs.

For the years 1968 and 1969 plaintiff's reported net incomes from all sources were $201,362 and $116,394. Plaintiff's balance sheets per its tax returns for the years in suit (which because of the cash method of accounting do not reflect income tax liabilities of $94,970 and $35,182, respectively) show the assets, liabilities and capital and retained earnings as follows:

[2] While plaintiff did assume the burden of guaranteeing Ryder a minimum of 130,000 miles per truck per year, this too entailed little risk, since the amounts paid Ryder show that the trucks were operated far beyond the minimum mileage even when carrying only about half of Ohio's loads.

Opinion of Trial Judge

Assets	6/30/68	6/30/69
Cash	$83, 221. 91	$164, 786. 91
Loans to stockholders	12, 000. 00	40, 000. 00
Mortgage and real estate loans	37, 158. 63	36, 091. 56
Other investments	200, 000. 00	99, 665. 00
Fixed assets less depreciation	10, 215. 84	13, 395. 96
Oil leases	3, 623. 78	3, 149. 90
Organization cost	293. 66	293. 66
Total Assets	$346, 513. 82	$357, 382. 99
Liabilities and Capital		
Payroll taxes	$1, 500. 61	$1, 909. 24
Common stock	9, 600. 00	19, 200. 00
Paid in surplus	641. 66	641. 66
Retained earnings	334, 771. 55	335, 632. 09
Total Liabilities and Capital	$346, 513. 82	$357, 382. 99

However, the retained earnings have to be increased for tax purposes to restore a capitalization of earnings by way of stock dividends which have no effect under the tax laws. Thus, the corrected figures are as follows:

	6/30/68	6/30/69
Accumulated earnings and profits	$339, 571. 55	$350, 032. 09

The assets in the foregoing balance sheets were almost all liquid or amounts due it from its stockholder. The "Other investments" in 1968 consisted of United States Treasury bills and certificates of deposit, and in 1969 they included also a purchase of a large amount of silver bullion on margin through a Zurich, Switzerland bank. The mortgage and real estate loans were amounts owing from Charles Searight. The fixed assets were shares of the drilling equipment used by the operators of oil and gas working interests in which plaintiff had made investments and which were imputed to plaintiff for tax depreciation purposes.

Despite the substantial accumulated earnings plaintiff made no distributions of dividends in any of the years 1965 through 1968 and only distributed $96 in 1969. In lieu thereof plaintiff made loans to its stockholder. On July 31, 1967, Mississippi lent Charles Searight $38,000 at 6 percent interest, secured by a mortgage with a 20-year term, for making home improvements and refinancing his mortgage loan. Plaintiff also made other loans to its sole shareholder without

collateral, ranging in amounts from $5,000 to $140,000, for terms varying from 30 days to 6 months and at interest rates from 5 to 6½ percent. At the end of 1968 Charles Searight owed plaintiff $12,000 and at the end of 1969, $40,000; however, from October 30 to December 31, 1968, he owed plaintiff $80,000, and from December 31, 1968, until June 30, 1969, he owed plaintiff $130,000. The purpose of these loans was to enable Searight to engage in stock market speculation on his own account, to invest in oil and gas ventures and to speculate in silver futures contracts.

Plaintiff also engaged in speculative investments with surplus funds in its own name. In July 1968 it purchased 145,000 ounces of silver bullion through a Swiss bank for $332,976, at 15 percent margin, putting up $49,665 in cash. As of June 30, 1969, the market value of the silver had declined by $108,170 requiring plaintiff to put up additional margin to cover the loss. It purchased 500 shares of Occidental Petroleum common stock for $41,402 on June 9, 1967, sold 200 of the shares 14 days later at a $5 per share gain, repurchased 200 more shares on July 11 after a $3 per share decline in price, and disposed of the entire 500 shares on November 14, 1967, for $41,901. On October 25, 1967, plaintiff purchased 500 shares of Grumman stock for $15,987 and sold them on February 29, 1968, for $16,820. And, as will be discussed later, during 1968 and 1969 it invested $98,342 in fractional working interests in oil and gas drilling projects, which for the most part were wildcats.

Plaintiff contends that it accumulated its earnings to meet reasonably anticipated business needs. The first of these alleged needs was for $349,140 to pay for the cost of a fleet of ten trucks and an operational service facility. While the sum is not unreasonable as an estimate of the cost of acquiring the equipment and facilities, it is difficult to credit the testimony of Charles Searight and Bob J. Young that they had any such actual plan during those years. First, the plan to acquire the vehicles, facilities and personnel is not supported by any contemporaneous documents in existence or prepared during the taxable years at issue. Young testified that he prepared an estimate on a single scratch sheet on an unspecified date, which neither thought important enough to retain. The use of such funds in speculative fliers both by the corporation

and by its stockholder with money borrowed from the corporation is also hardly consistent with the asserted purpose of preserving the accumulation as a reserve to meet anticipated business needs.

Prior to 1961 Mississippi had owned and operated three trucks, which it leased to Ohio. On the basis of that experience Charles Searight was convinced that it was not economically feasible to service them through commercial garages, or to provide the facilities and personnel to maintain them short of having at least ten vehicles in full use throughout the year. Although since that time plaintiff had been occasionally able to use nine to ten trucks temporarily in peak seasons, it was never able to stabilize its shipping volume at the ten-truck level. Even as of May 1969, one month before the end of the fiscal year, when plaintiff made its last lease renewal from Ryder for 3 more years, plaintiff would not take the risk of leasing more than six vehicles to furnish to Ohio on a year-round basis. It can hardly be concluded that at or about that time plaintiff seriously considered putting out $349,140 to purchase ten vehicles and a service facility and to hire the trained service personnel to go with it.

Charles Searight testified that a reason for the accumulation for the proposed purchase was that plaintiff's increased profits for 1968 and 1969 raised the probability that Ohio would refuse to renew its lease unless it obtained more favorable rates from plaintiff. This is inconsistent with the fact that in May 1969 Ohio renewed its lease for 3 years on the same terms without any reduction in rates. Furthermore, there is lacking any correlation between a proposed rate reduction and the need to purchase the equipment. There was ample room in plaintiff's profits to enable it to reduce its shipping rates to Ohio and still continue to lease the trucks from Ryder. There is no evidence of any study or analysis which convinced plaintiff that it needed to purchase and service the equipment it furnished Ohio in order to be able to charge the latter less than if it continued to lease the equipment from Ryder under a full-service contract.

It is apparent that the extent of plaintiff's profits was not a factor in Ohio's willingness to enter into the sublease. The sublease could not by any stretch of the imagination be

termed one that was either negotiated at arm's length, or served some business purpose of Ohio. Thereunder, Ohio not only paid the same common carrier rates it would have paid in any event for its shipments, but in addition it bore the cost of supervision of the truck drivers, advanced their wages and furnished Mississippi free clerical personnel, free premises, free long-distance telephone and other facilities. It did not even result in the economy to Ohio of eliminating the need for its own traffic department, since plaintiff only took the shipments which were profitable to itself. If the financial benefit of the arrangement to Mississippi and the lack of benefit to itself was of no concern to Ohio before the end of 1969, and if it did not object to its renewal for 3 more years in May 1969, what reason did plaintiff have to believe that Ohio was on the verge of terminating the arrangement in 1968, 1969, or shortly thereafter? Finally, William Searight, who held the controlling interest in Ohio, testified that apart from the objections of possible merger candidates, Ohio was perfectly satisfied with the existing subleasing arrangement and had no intention of canceling it absent a merger with an unrelated party.

Charles Searight also claimed that he needed the $349,140 accumulation to purchase the trucks and facilities because it was increasingly obvious to him in 1969 that Ohio would be merged with another company and that the other company would insist on terminating the middleman sublease arrangement, which plaintiff found so profitable. Several merger candidates had already insisted that the trucking operations be included in the merger. But if absent the merger there was no reason for plaintiff to accumulate the funds to buy the trucks, There was even less need for the accumulation to buy the trucks in contemplation of the merger. If to an independent merger candidate the truck-sublease arrangement could not be justified as serving Ohio's business purposes, it was explainable only as a device for the reallocation or diversion of profits among family members. After the merger the Searights would continue their interests as stockholders in the merged company. Indeed, after the 1972 merger with Ferro Corporation, Charles Seabright also retained his managerial role as vice president and general manager of the Cata-

phote Division of Ferro. It is fair to infer that this was one of the things for which the owners of Ohio bargained, or at least for which Charles Searight hoped. It was utterly unreasonable to expect that the merged company (and particularly a publicly owned one) would allow a substantial stockholder and officer to continue to make profits in dealing with himself in an obvious conflict-of-interest situation, whether he leased the trucks or owned them.

Even apart from the conflict-of-interest problem Mississippi had little or nothing to offer to an independent company. Its two officers were already employees of Ohio and there is no evidence that they had any intention of leaving voluntarily after the merger. Plaintiff had no other operating or service personnel with skills or know-how valuable to the merging company. Even if it purchased the ten trucks and a small service facility plaintiff believed a minimum prerequisite for a successful operation, plaintiff offered no evidence that it had reason to believe the merging company would have any need for that many vehicles when neither Mississippi nor Ohio could use them profitably. And, equally important, plaintiff offered no evidence that it believed or had a reasonable basis for assuming that it could compete with a national leasing organization in purchasing, financing and providing full service for vehicles on a national basis even if it contributed the interest value of the relatively minor additional working capital used in its business (discussed, *infra*).

If the new company declined to enter into such a lease with Mississippi plaintiff would have had no use for the trucks and facilities it would own, since it had no certificate of convenience and necessity, and since in Charles Searight's view the location was not economically desirable for an independent trucking business. Under the circumstances plaintiff could hardly have planned investing $349,140 in new vehicles and facilities for which its use was highly problematic.

Plaintiff's May 1969 renewal of the Ryder lease and the sublease for another 3-year period, despite Ohio's plans for a merger is not consistent with an intention by plaintiff to purchase its own trucks and facilities at least through 1972. The fact is also that plaintiff has never purchased any trucks

or constructed a service facility, and there is no explanation in the record as to any change in circumstances which resulted in the change in the alleged plans. "The more extended continuity is enlightening, and we see no reason to draw the curtain against parts of it." *Maytag* v. *United States*, 153 Ct. Cl. 622, 628, 289 F. 2d 647, 650 (1961).[3]

All businesses face contingencies in varying degrees and probabilities, and if one thinks hard enough it is always possible to conjure up a contingency which will justify an accumulation however large. But so broad an interpretation of "the reasonable needs of the business" would obviously nullify the operation of the statute. In the enactment of the Internal Revenue Code of 1954 (sec. 537) Congress broadened the definition of reasonable needs to include the "reasonably anticipated needs" of the business. However, the committee sponsoring the measure cautioned that the plans for using the accumulation must be specific and definite, rather than uncertain or vague, to render the tax inapplicable:

> It is contemplated that this amendment will cover the case where the taxpayer has specific and definite plans for acquisition of buildings or equipment for use in the business. It would not apply where the future plans are vague and indefinite, or where execution of the plans is postponed indefinitely. [S. REP. No. 1622, 83rd Cong. 2d Sess. 69; 3 U.S.C. CONG. & ADM. NEWS 1954, 4701.]

and

> In any case where there exists a definite plan for the investment of earnings and profits, such corporation need not necessarily consummate these plans in a relatively short period after the close of the taxable year. However, where the future needs of the business are uncertain or vague, or the plans for the future use of the accumulations are indefinite, the amendment does not prevent application of the accumulated earnings tax.

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[3] *See also* S. REP. No. 1622 on Internal Revenue Code of 1954, 83rd Cong. 2d Sess. 69–70 (3 U.S.C. CONG. & ADM. NEWS 1954, 4701):

"If the retention of earnings is justified as of the close of the taxable year, subsequent events should not be used for the purpose of showing that the retention was unreasonable in such year. However, subsequent events may be considered to determine whether the corporation actually intended to consummate the plans for which the earnings were accumulated."

Section 1.537–1(b)(2) of the Treasury Regulations reiterates the same language.

[H. REP. No. 1337, 83rd Cong. 2d Sess. A173; 3 U.S.C. CONG. & ADM. NEWS 1954, 4312.]

Taking its cue from the committee reports, Treasury Regulations section 1.537–1(b)(1) similarly states that to justify an accumulation, plans for its future use must be "specific, definite, and feasible" rather than "uncertain or vague."

As the court stated in *Bahan Textile Machinery Co.* v. *United States*, 453 F. 2d 1100, 1102 (4th Cir. 1972):

> It is no excuse to say, as Taxpayer does, that the alleged future plans lacked specificity because it was a small, informally-conducted corporation and that "every time Edward F. Bahan sat at his desk, the Board of Directors was in session." The specificity requirements were written into the regulations by the Commissioner precisely because a loosely run corporation like the appellant presents a high potential for post hoc, unsupported rationalizations for the prohibited hoarding of profits.

And *see also Estate of Goodall* v. *Commissioner*, 391 F. 2d 775, 799 (8th Cir. 1968), quoting with approval from *Smoot Sand & Gravel Corp.* v. *Commissioner*, 241 F. 2d 197, 202 (4th Cir.), *cert. denied*, 354 U.S. 922 (1957): "The intention claimed must be manifested by some contemporaneous course of conduct directed toward the claimed purpose."; *Dixie, Inc.* v. *Commissioner*, 277 F. 2d 526, 528 (2d Cir.), *cert. denied*, 364 U.S. 827 (1960): It is not sufficient to "recognize a future problem and discuss possible and alternative solutions. * * * Definiteness of plan coupled with action taken toward its consummation are essentials."

On the basis of the evidence it must be concluded that at most the purchase of vehicles and facilities was merely a possibility discussed over a period of years but not ever found to be sufficiently feasible or warranted so that plaintiff actually accumulated its earnings for that purpose.

Plaintiff also claimed a need for the accumulation of about $100,000 for working capital needs of the existing business. Since Ohio paid plaintiff only as its customers paid for their merchandise and shipping, plaintiff extended credit to Ohio for up to 4 months. On the other hand, plaintiff's payments to Ryder were due 10 days after monthly billing from Ryder for mileage operated during the prior month. To the extent

that the payment of expenses may be postponed as a result of credit arrangements, the need for operating capital is reduced. *See W. L. Mead, Inc.* v. *Commissioner*, P-H Mem. T.C. ¶ 75,215 (1975); *Kingsbury Investments, Inc.* v. *Commissioner*, 28 TCM 1082, 1088–89 (1969); and B. BITTKER AND J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 8–16 (3rd ed. 1971). Taking into account the 15-day average delay implicit in monthly billing, the time needed to prepare and mail the bills plus the 10 days to respond, it is reasonable to conclude plaintiff had 30 days credit on its payables to Ryder to offset partially the delays in the collection of its own receivables.

On the basis of the evidence it is concluded that for each of the years 1968 and 1969 plaintiff's trucking operations required approximately $45,000 in working capital to cover vehicle lease costs, rental of additional trucks during peak months, tolls, salaries of its two officers, insurance and legal and audit fees. This is based on application of the so-called *Bardahl* method or formula (*Bardahl Manufacturing Corp.* v. *Commissioner*, 24 TCM 1030 (1965)). A synopsis of the method is set forth in B. BITTKER AND J. EUSTICE, *supra*, at 8–15 to 16, as follows:

> The operating-cycle test, first enunciated by the Tax Court in the *Bardahl* case in 1965 and refined by later decisions, permits accumulations of current earnings to cover reasonably anticipated costs of operating a business for a single operating cycle. The length of the cycle is the period during which money is tied up in inventory or accounts receivable, and hence is unavailable for dividend distributions by the company. This cycle may be described as the time needed to convert cash into raw materials, raw materials into finished goods, inventory into sales and accounts receivable, and any accounts receivable into cash.[4]

The following computation is in accord with the *Bardahl* formula as generally applied by the parties to the facts of this case, but is modified as explained in the footnotes:

[4] And *see also Apollo Industries, Inc.* v. *Commissioner*, 358 F. 2d 867, 871–72 (1st Cir. 1966); and *W. L. Mead, Inc.* v. *Commissioner*, *supra*.

Opinion of Trial Judge

The Accounts Receivable or Collection Cycle	*1968*	*1969*
1. Yearly revenues	[1] $630,169	[1] $581,140
2. Accounts Receivable—Beginning of year	−110,413	[2] −98,887
3. —End of year	[2] +98,887	[2] +74,205
4. Yearly revenues restated on accrual basis	618,643	556,458
5. Peak Accounts Receivable	147,932	115,740
6. Peak Receivables cycle as percentage of annual total (line 5 divided by line 4)	23.91%	20.80%
7. Peak Receivables cycle expressed in days of year	87	76
8. Days in peak Receivables cycle as percent of year (line 7 divided by 365)	23.91%	20.80%
Working Capital Needed To Pay Truck Rentals and Other Payables During Peak Receivables Cycle		
9. Annual truck rentals	$214,126	$246,400
10. Average Payables cycle for truck rentals (30 days) as percentage of year	[3] 8.33%	[3] 8.33%
11. Difference between peak Receivables cycle and truck rentals Payable cycle, as percent of year (line 8 minus line 10)	15.58%	12.47%
12. Working Capital needed to pay truck rentals for one peak Receivables cycle (line 9 times line 11)	$33,361	$30,726
13. Compensation-Officers	[4] 34,378	[4] 34,284
14. Pension	7,310	13,875
15. Other Payables	6,638	11,194
16. Total	48,326	59,353
17. Working Capital needed to pay other expenses during one peak Receivables cycle (line 16 times line 8)	11,555	12,345
18. Total Working Capital requirements during peak Receivables cycle (line 12 plus line 17)	$44,916	$43,071

[1] Mississippi income tax returns for fiscal year 1968 reported gross receipts of $512,861 and for fiscal year 1969, $471,651. However, the tax returns were not reported in the same manner as the accounts were kept. The tax returns reported only cash received. The accounts show that Mississippi's gross billings to Ohio were not paid wholly in cash. Payments were also made by way of offsets for truck drivers' wages and related expenses paid by Ohio in the sums of $117,308 in 1968 and $109,489 in 1969. Inasmuch as the agreed peak receivables used by both parties in their computations are based on peak gross billings, determination of the collection cycle must likewise be made by comparison with annual gross billings. Accordingly, the $117,308 and $109,489 have been added back to the sales figures plaintiff stated on its income tax returns.

[2] Includes addition of $26,400 not yet received by Mississippi at end of fiscal year 1968, although carried as paid June 25, 1968, on Ohio's records. For fiscal year 1969 the additional amount of $10,000 was included as accrued by Mississippi from June 25, 1969 billing in the amount of $19,011.

[3] Since neither party offered evidence of peak payables, average payables are used here and only with respect to amounts due Ryder.

[4] Agreed upon salary expenses of $48,709 in fiscal year 1968 and $60,784 in fiscal year 1969 have been reduced by bonuses paid over and above basic compensation, amounting to $14,331 in fiscal year 1968 and $26,500 in fiscal year 1969, inasmuch as these year-end payments are based on profits and are not considered to be a cyclical expense in computing necessary working capital.

Opinion of Trial Judge

Plaintiff contends further that it was in the oil and gas business and for that business as of the end of 1968 it required $201,588 and as of the end of 1969 it required $62,249 in reserves and operating capital. The facts are that during the 2-year period plaintiff invested $98,342 in 26 separate fractional minority working interests in oil and gas drilling ventures in Mississippi. Charles Searight was originally drawn to such investments as a tax shelter, starting with 1/128 and 1/64 working interests. After he let it be known he was in the market for further opportunities, various independent oil operators and promoters would solicit his financial participation in their projects. Beginning in 1964 he initiated the plaintiff corporation into the acquisition of such interests. Thereafter, whether he personally or the corporation made the investment depended on which had the available funds at the time a promoter sold him on an operation.

A typical form agreement between the oil producer and plaintiff provided that the producer assigned to plaintiff a 1/16 (or other fractional undivided) interest in a lease and the promoter agreed to commence or cause to be commenced by a stated date drilling operations for a test well on the property at his own cost, risk, expense and liability to a preset contract depth and to make appropriate tests for oil and gas. In return plaintiff agreed to pay $1,800 (or other fixed sum) to the producer. After the test well was drilled to contract depth, electric logged and side-wall cored by the producer, each party was to have a 24-hour period in which to agree or decline to participate in the cost of completion of the well. An agreement as to costs of completion was then made in which payments were due in the same proportion. If plaintiff declined further participation, his interest was to be assigned to other parties electing to complete the well. The producer was to be in charge at all times, but plaintiff was to have the right of access to inspect the work and to witness tests. The producer agreed to indemnify and to hold plaintiff harmless from all claims and demands resulting from the drilling other than the amount it had agreed to. The agreement expressly stated that it should not be construed as creating a partnership or joint venture. Of the 26 prospects drilled in the 2 years at issue, plaintiff's financial

participation in 14 was limited to a 1/16 interest, in two to a 1/8 interest, and in one to a 1/4 interest. The record does not disclose the extent of plaintiff's share in the nine others. Twenty-one of the 26 involved an initial commitment by plaintiff of $3,000 or less, one as little as $700. Most of the wells were wildcats.

Plaintiff's participation involved only the activity of Charles Searight, Bob Young having little or nothing to do with it except to keep plaintiff's books. Searight's activities included the evaluation of the promoters' offerings, the initial decisions on whether or not to make investments in projects, the receipt and evaluation of drilling reports and of the operators' advice on whether to continue or to abandon or forfeit after the initial drillings, and decisions with respect to the investment of additional capital for deeper drilling and additional test wells. If a well had a possibility of commercial production, he had to decide on whether or not to put up additional proportionate funds for casing or pipe and for additional development wells on the same tract to exploit the deposit. Searight had no expert geological training and employed no geologist but relied on the advice of the particular operator or of other promoters with whom he dealt and he occasionally consulted friends in the oil and gas business. Mr. James Furrh, who promoted a number of the projects, testified that Searight was usually too busy to go out and visit the wells in which plaintiff invested but did receive and read the operators' reports. Neither Searight nor plaintiff engaged in any of the actual operations of well drilling, contracting for drilling, testing, employing or supervising workmen, purchasing materials or selling petroleum.

In addition to the operator indemnifying plaintiff against claims and demands in excess of its original commitment he usually also provided general public liability insurance for drilling hazards up to a specified amount. Plaintiff purchased excess liability insurance to cover catastrophic liability beyond that.

Investment in securities of companies which are unrelated to the activities of the business of a taxpayer corporation may be evidence of an accumulation of earnings beyond the reasonable needs of the business. *Helvering* v. *Chicago Stock*

Yards Co., 318 U.S. 693, 701 (1943); *Helvering* v. *National Grocery Co.*, 304 U.S. 282, 291–92 (1938); Treas. Regs. § 1.537–2(c). For purposes of the accumulated earnings tax, a taxpayer does not become engaged in the business of an unrelated corporation merely by acquiring a minority stock interest therein. Treas. Regs. § 1.537–3. Similar provisions have existed in every regulation on income taxes since Treasury Regulations 45, Article 352, under the Revenue Act of 1918. And the same has been held with respect to a corporation acquiring a fractional limited partnership interest in another business. *Turner* v. *Commissioner*, 24 TCM 544, 558 (1965).

Similarly the acquisition of a fractional working interest in an oil or gas venture does not necessarily place one in the oil or gas business. *Kerr-Cochran, Inc.* v. *Commissioner*, 253 F. 2d 121, 128 (8th Cir. 1958), *affirming* 14 TCM 304, 311 (1955); *Kerr-Cochran, Inc.* v. *Commissioner*, 30 T.C. 69, 80–82 (1958). The line to be drawn between the ownership of a working interest which is equivalent to being in the oil and gas business and one which is akin to a mere corporate stock investment depends upon the magnitude of the interest and whether or not the owner also has direct operating and management responsibilities. *Cf. Nemours Corp.* v. *Commissioner*, 38 T.C. 585, 601 n. 3 (1962), *affirmed per curiam*, 325 F. 2d 559 (3rd Cir. 1963) and *John Provence #1 Well* v. *Commissioner*, 321 F. 2d 840 (3rd Cir. 1963). Plaintiff had no such responsibilities here.

On the basis of all of the evidence it is concluded that plaintiff's participation by minority interests in drilling ventures was not a part of its business but merely a series of investments or speculations unrelated to its business. It had no personnel engaged in the operation of such businesses and it did nothing to manage or operate them. In view of Charles Searight's other duties and responsibilities as president of Ohio plus his duties and responsibilities as president of Mississippi to provide trucks for Ohio's shipments, it would be remarkable if he also found time to engage in the operations of 26 other separate businesses involved in oil exploration, well drilling and production. His activities with respect to the latter amounted to no more than checking on

his investments and making decisions on whether or not to make initial and additional investments or to dispose of them. This is not very different from the decisions that one has to make in investing in stocks or commodities on margin. For purposes of the tax laws "investing is not a trade or business." *Whipple* v. *Commissioner*, 373 U.S. 193, 202 (1963).

While the making of investments is not necessarily inconsistent with the retention of earnings to meet anticipated needs of the business, investing in minority interests in other businesses is not a business need in itself which can justify the accumulation of earnings. If this were not so, an obvious method of avoiding the tax would be available to everyone, *i.e.*, merely by investing liquid assets in stocks. *Ivan Allen Co.* v. *United States*, 422 U.S. 617, 629–30 (1975); *Oyster Shell Products Corp.* v. *Commissioner*, 313 F. 2d 449, 454 (2d Cir. 1963). All excess earnings are invested in one form or another, even when they are in the form of bonds or in bank deposits bearing interest.

As of June 30, 1968, plaintiff's accumulated earnings and profits were $339,572. At that time the reasonable needs for accumulations in plaintiff's business were not in excess of $139,970, consisting of—

(a) Accrued and unpaid income taxes, $94,970;
(b) Working capital, about $45,000.

Thus plaintiff allowed its earnings and profits to accumulate beyond the reasonable needs of its business.[5]

As of June 30, 1969, plaintiff's accumulated earnings and profits were $350,032. As a result of the decline in value of plaintiff's investment in silver bullion by $108,170, the net accumulated earnings and profits available for use in its business were as a matter of economic reality reduced to $241,862. *Ivan Allen Co.* v. *United States*, *supra*. At that time the reasonable needs for accumulations in plaintiff's business were not in excess of $80,182, consisting of—

(a) Accrued and unpaid income taxes, $35,182;
(b) Working capital, about $45,000.

[5] This conclusion would not be changed even if plaintiff were deemed to have been in the oil and gas business, as plaintiff's needs for such activities were in any event not sufficient to require the excess accumulation.

Thus plaintiff allowed its earnings and profits to accumulate beyond the reasonable needs of its business.[6]

In addition to the fact of the accumulation beyond the reasonable needs of the business which both logic and the statute make presumptively determinative of the purpose to avoid the income tax with respect to its shareholder, there is other evidence of such purpose. There is the almost complete absence of cash dividends, and coupled with it are substantial loans to the stockholder for his personal and speculative needs. As the Court noted in *Helvering* v. *National Grocery Co.*, 304 U.S. 282, 293–94 (1938) (quoting from Judge Learned Hand in *United Business Corp.* v. *Commissioner*, 62 F. 2d 754, 755 (2d Cir. 1933)), "These loans are incompatible with a purpose to strengthen the financial position of the [corporation], but entirely accord with a desire to get the equivalent of [the controlling stockholder's] dividends under another guise." And *see also Oyster Shell Products Corp.* v. *Commissioner*, *supra*.

It is also pertinent that Charles Searight avoided substantial amounts of federal income tax by having his corporation accumulate rather than distribute its earnings during the 2 years in issue. *Helvering* v. *National Grocery Co.*, *supra*; *American Metal Products Corp.* v. *Commissioner*, 287 F. 2d 860, 865 (8th Cir. 1961). For 1968 his return showed taxable income of $50,023. Had plaintiff distributed the income available for dividends out of the earnings for that year he would have received an additional $106,392. This would have resulted in his having to pay additional personal federal income tax of $69,317. For the year 1969 his reported personal taxable income was $51,649. Had plaintiff's available earnings for that year been distributed he would have had an additional $65,616 in income and this would have resulted in an additional $41,574 in taxes.

It must therefore be concluded that plaintiff was availed of for the purpose of avoiding income taxes with respect to its sole shareholder by permitting its earnings and profits to accumulate instead of being distributed in 1968 and 1969, and that the determination to that effect by the Commissioner of Internal Revenue is correct.

[6] *See* n. 5, *supra*.

Another issue still remains. For the years in suit section 51(a)(1)(B) of the Internal Revenue Code levied a tax surcharge on the income of every corporation equal to 10 percent of the "adjusted tax". Subsection (b) defines "adjusted tax" as the "tax imposed by this chapter for such taxable year" with certain omissions. Plaintiff contends that the accumulated earnings tax is not within the term "adjusted tax" and that therefore the base for the 10 percent surcharge does not include the accumulated earnings tax.

"This chapter" to which section 51(b) refers is chapter 1, entitled "Normal Taxes and Surtaxes." It encompasses sections 1 through 1388 of the Code. The accumulated earnings tax is imposed by section 531, which is of course included in chapter 1. Section 531 provides that "In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income * * * of every corporation * * * an accumulated earnings tax * * *." Thus the accumulated earnings tax fits literally the definition in section 51(b).

Plaintiff's argument that the accumulated earnings tax is in the nature of a penalty or addition to the tax does not avoid the literal language of the statute. The tax surcharge was purely a revenue-raising measure equivalent to raising the rates on each category of tax in chapter 1. There is nothing to show that Congress intended to exempt this particular portion of the tax imposed by chapter 1.

In addition, there is language in the legislative history which shows that Congress did give its attention to the problem and specifically intended that the surcharge apply to the accumulated earnings tax. The surcharge did not appear in the original committee reports. It was first proposed and adopted on the floor of the Senate. As a result, on June 10, 1968, the Conference Committee found it necessary to make a general explanation of its report to the members of Congress. The pertinent portion of this Conference Committee statement is as follows (Explanation of H.R. 15414, 90th Cong., 2nd Sess., Revenue and Expenditure Control Act of 1968, 114 CONG. REC. 17,993 (1968)):

> The surcharge, as previously explained, is a percent of the amount of the income taxes (without regard to additions to tax or penalties) imposed by chapter 1 of

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the code with certain adjustments. With the exception of certain items, noted below, *the surcharge* applies with respect to all taxes imposed by chapter 1. For example, the surcharge applies with respect to the tax on capital gains (but not in the partial tax computation necessary to determine if the alternate capital gains tax is applicable); it *also applies with respect to the tax on accumulated earnings of corporations*, to the personal holding company income tax, etc. [Emphasis supplied.]

In addition, defendant asserts that plaintiff is barred from raising this contention because it failed to include it in any claim for refund. The first time the contention appears is in plaintiff's brief. This defense must likewise be upheld. (*Alexander Proudfoot Co.* v. *United States*, 197 Ct. Cl. 219, 454 F. 2d 1379 (1972); *Estate of McCabe* v. *United States*, 201 Ct. Cl. 243, 246, 475 F. 2d 1142, 1144 (1973); *Armstrong Rubber Co.* v. *United States*, 207 Ct. Cl. 1023 (1975).)

CONCLUSION OF LAW

Upon the findings of fact and the foregoing opinion, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover and its petition is therefore dismissed.

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535 F. 2d 62

JO-BAR MANUFACTURING CORPORATION v. THE UNITED STATES

[No. 418–74. Decided May 12, 1976]

OPINION

Contracts; constructive change; timeliness of claim for equitable adjustment.—Plaintiff entered into a contract to supply at stated unit and total contract prices engine lubrication pump assemblies manufactured in accordance with certain specified Government-furnished drawings. Subsequently, plaintiff discovered that assembly drawings were missing from the technical data package; upon notification, defendant furnished them. Thereafter plaintiff completed the contract. This case is before the court for review under Wunderlich Act standards of a decision of the Armed Services Board of Contract Appeals denying plaintiff's claim for an equitable adjustment on the ground that the claim was not asserted prior to final contract payment and was therefore barred by the time limitations

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of the contract's Changes clause. The Board found that the recollection of a Government industrial specialist of a conversation with some representative of plaintiff, approximately a year after plaintiff's receipt of the missing drawings, during which the comment was made that plaintiff "would have to get more money" or was "going to ask for more money," did not constitute a valid and proper claim under the Changes clause but was at best an expression of an indefinite intent to seek a price adjustment as distinguished from a demand predicated upon an express contractual right. Plaintiff claims that as a result of the admittedly incomplete technical data package, it performed work and incurred costs neither contemplated in bidding nor included in its bid price. It is *held* that the ambiguous and casual statement to one authorized to provide plaintiff only technical assistance does not amount to a proper assertion of a claim to an equitable adjustment in the contractually prescribed manner, and an administrative decision so holding is neither arbitrary, capricious, unsupported by substantial evidence nor legally erroneous. Plaintiff is not entitled to recover and its petition is dismissed.

Contracts; disputes; administrative findings; finality of findings; mixed questions of law and fact.

[1] Where the Board found that the contractor had failed to prove it had manifested, prior to final contract payment, a positive intention to assert a claim for an equitable adjustment as a matter of legal right either to the contracting officer or one empowered to act for him in such matters, such findings reflect both factual and legal determinations. Absent a showing that the factual findings were arbitrary, capricious, or unsupported by substantial evidence, they are final and, absent a showing that they are erroneous, the administrative legal conclusions, while not binding, also deserve to be sustained.

United States ⇐ 74(1)

Contracts; changes; constructive change; claim for equitable adjustment; necessity for timeliness.

[2] In a constructive change situation, notice of a claim for an equitable adjustment under the Changes clause need not be presented within the specific number of days allowed, thereby, but the filing of a claim within the period of administration of the contract is plainly a requisite. However, where the contracting officer knows, or is properly chargeable with knowledge, that at the time of final payment the contractor is asserting a right to additional compensation, even though formal claim therefor has not been filed, the fact of final payment does not bar consideration of a later formal claim.

United States ⇐ 72(5)

Contracts; changes; administrative remedies; how pursued under Changes clause.

[3] Where the Changes clause of the contract provides for the filing of a formal claim for an equitable adjustment within a speci-

fied time, the claim must bear some of the attributes of a claim itself, purporting to be in the nature of a claim as of legal right.

United States ⟸ 72(5)

Asher W. Sweeney, attorney of record, for plaintiff.

Stephen G. Anderson, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Sheldon J. Wolfe*, of counsel.

Before SKELTON, KASHIWA, and BENNETT, *Judges.*

PER CURIAM: This case comes before the court on defendant's motion, filed March 8, 1976, requesting that the court adopt, as the basis for its judgment in this case, the recommended decision of Trial Judge Harry E. Wood, filed January 28, 1976, pursuant to Rule 166(c) on plaintiff's motion and defendant's cross-motion for summary judgment, plaintiff having failed to file a request for review thereof by the court and the time for so filing pursuant to the Rules of the court having expired. Upon consideration thereof, without oral argument, since the court agrees with the decision, as hereinafter set forth, it hereby grants defendant's motion and affirms and adopts the decision as the basis for its judgment in this case. It is therefore concluded that the decision of the Armed Services Board of Contract Appeals denying plaintiff's claim for an equitable adjustment in contract price pursuant to the Changes clause, as not properly asserted prior to final payment, was neither arbitrary, capricious, unsupported by substantial evidence, nor legally erroneous and, accordingly, plaintiff's petition seeking reversal of that decision is hereby dismissed.

OPINION OF TRIAL JUDGE

WOOD, *Trial Judge:* In this contract action, plaintiff seeks review, under Wunderlich Act standards,[1] of a decision of the Armed Services Board of Contract Appeals[2] denying plaintiff's claim for an equitable adjustment in contract price on the ground that plaintiff's claim thereto was not asserted

[1] 68 Stat. 81, 41 U.S.C. §§ 321–22 (1970).

[2] ASBCA No. 18766, 74–1 BCA ¶10,585. The administrative hearing was limited to issues of entitlement only.

prior to final contract payment, and was therefore barred by the time limitations contained within the contract's Changes clause.[3]

Plaintiff here contends that in consequence of an admittedly incomplete technical data package furnished to it prior to bidding, it performed work, and incurred costs, neither contemplated in bidding on, nor included in its bid price for, the contract work; that it gave proper and timely notice to defendant of its claim to an equitable adjustment in contract price; and that the administrative decision denying the claim as untimely is not entitled to finality. Defendant, of course, urges that the administrative decision should be upheld.

The relevant facts found by the Board, or otherwise established by the administrative record, are briefly stated below. For reasons hereinafter appearing, it is concluded that plaintiff is not entitled to recover.

On December 30, 1970, defendant, acting through the Defense Supply Agency, Defense Construction Supply Center, Columbus, Ohio, issued an invitation for bids covering some 462 engine lubrication pump assemblies to be manufactured in accordance with certain specified, government-furnished drawings. Plaintiff responded to the IFB January 27, 1971, and, on April 8, 1971, was awarded a contract to furnish the said pump assemblies at a unit and total contract price of $66.13 and $30,552.06, respectively.

In October 1971, when plaintiff was ready to assemble the various components making up the pump assembly, it discovered that assembly drawings were missing from the technical data package. It is here conceded that defendant failed to furnish to plaintiff a complete technical data package, and that plaintiff was not chargeable with knowledge of the missing drawings prior to bidding on the contract in suit.

On October 1, 1971, Mr. Matheny, a government industrial specialist, had been assigned to plaintiff's plant for "surveillance and [technical] assistance purposes." On discovery of the missing drawings, plaintiff discussed them with Mr. Matheny and with Mr. Fruth, a government engineer at the

[3] The text of the contract's standard Changes clause appears at 32 C.F.R. § 7.103-2 (1965 Rev.).

Defense Construction Supply Center in Columbus, and defendant forwarded the missing drawings to plaintiff December 30, 1971.

The administrative record contains vague, ambiguous and to a degree conflicting evidence concerning what plaintiff did (or did not) do, prior to final contract payment, about the costs allegedly incurred in complying with the assembly drawings furnished to it December 30, 1971.

Plaintiff's chief executive officer, its sole witness, testified that on receipt of the missing drawings she told both Mr. Matheny and Mr. Fruth plaintiff "would be" claiming additional compensation in consequence of those drawings. As the Board accurately observed, however, that same witness also testified that the government representatives to whom she had spoken about a price adjustment had "indicated to her that [plaintiff] should file a claim for whatever additional costs were involved."

Both Mr. Matheny and Mr. Fruth flatly contradicted plaintiff's testimony. Mr. Fruth denied any conversation with plaintiff concerning additional costs. Mr. Matheny testified he had no conversation with plaintiff's chief executive officer concerning additional costs at the time the missing drawings were furnished to plaintiff.

The Board found that plaintiff had failed to establish that it had asserted a claim to an equitable adjustment under the contract prior to final contract payment. In so finding, the Board gave careful consideration to what it termed the sole item of "credible evidence * * * which even remotely resembles the assertion of a claim": Mr. Matheny's recollection of a conversation with some representative of plaintiff, approximately a year after plaintiff's receipt of the missing drawings, during which the comment that plaintiff "would have to get more money" or was "going to ask for more money" was made.

The Board noted Mr. Matheny's limited authority, and that Mr. Matheny had explained to plaintiff's chief executive officer, shortly after October 1, 1971, that his contractual assignment was limited to technical assistance. The Board concluded that the general comment he recalled (and to which he had attached no particular significance) did not

constitute a valid and proper claim under the Changes clause, but "at its best was an expression of an indefinite intent to seek a price adjustment as distinguished from a demand predicated upon an express contractual right."

In any event, following plaintiff's receipt of the missing drawings, it did complete the contract in due course. During contract performance there were several contract modifications, including one of June 6, 1972, by which plaintiff agreed to a minor reduction in unit and total contract prices, in exchange for a government extension of the contract delivery date. In February 1973, plaintiff submitted invoices to defendant, at a unit price of $66.13, covering the 462 engine lubrication pump assemblies. On March 16, 1973, defendant made a final contract payment of $30,348.78 to plaintiff.[4]

On April 20, 1973, plaintiff forwarded to the contracting officer a written claim for $38,734.08 for "additional time and costs necessary to incorporate drawings and dimensions not originally included with the basic bid package * * *."[5] The Board found no evidence that an intent to assert the claim was made in writing prior to April 20, 1973, and plaintiff does not, and cannot, challenge that finding.

On June 11, 1973, the contracting officer denied plaintiff's formal written claim on the ground that, not having been asserted until after final payment, it was untimely under the terms of the Changes clause. Plaintiff timely appealed the contracting officer's decision. As heretofore noted, the Board denied the appeal, stating that plaintiff had failed to establish "that it had manifested, prior to final contract payment, a positive intention to assert a claim as a matter of legal right either to the contracting officer or one empowered to act for him in such matters", and that there was "no valid basis for removing the [plaintiff's] claim from the time bar imposed by the Changes article."

At the outset, it should perhaps be noted that plaintiff not only did not question administratively the availability of relief under the Changes clause for defendant's defective

[4] The final payment was made at a unit price of $65.69. The reduced unit and total contract prices were in conformity with the June 6, 1972, contract modification referred to above.

[5] The claim, as made, amounted to more than the original total contract price.

technical data package, but affirmatively sought such relief from the contracting officer and later, the Board. Here too, relief is sought exclusively under the terms of the contract. For purposes of this decision, the validity of that position need not be explored. *Cf. Turnbull, Inc.* v. *United States*, 180 Ct. Cl. 1010, 1020–21, 389 F. 2d 1007, 1012 (1967).

In attacking the administrative decision, plaintiff asserts that defendant should have issued a written change order incorporating the missing drawings into the contract, so that plaintiff would have had an "established time period" within which to submit to the contracting officer its claim for an equitable adjustment. While the precise point plaintiff thereby endeavors to make is less than clear, this line of argument is in any event unsupported by logic, reason, or authority.

The Board expressed the view that a "simple change order should have been issued adding the missing drawings to the contract." That not having been done, however, the Board determined that defendant's forwarding of the drawings to plaintiff on December 30, 1971, amounted to a constructive change, and that it was plaintiff's responsibility timely (*i.e.*, before final payment, under the circumstances here present) to seek an equitable adjustment therefor, if warranted. In the present posture of the case, those determinations have not been shown to be legally erroneous or otherwise flawed. *Eggers & Higgins* v. *United States*, 185 Ct. Cl. 765, 785–86, 403 F. 2d 225, 236 (1968); *Turnbull, Inc.* v. *United States*, *supra*.

Plaintiff was an experienced government contractor. Its chief executive officer had been involved in government contracting for some 15 years. Had defendant issued a formal change order, plaintiff would have had a relatively short period within which to claim a right to an equitable adjustment under the Changes article. It in fact had some 14 months after receipt of the missing drawings within which to do so. *See Eggers & Higgins* v. *United States*, *supra*. That (as will be seen) it made no valid claim under the Changes clause until after March 16, 1973, is difficult to understand. In the circumstances of this case, however, any prejudice to plaintiff from the manner in which the change was effected resulted

from its own inactions in a situation calling for action, if warranted, and not from any fault on the part of defendant.

Plaintiff's principal contention is that it gave "proper notice to the Contracting Officer or Government pursuant to the provisions of the contract in issue" of its right to an equitable adjustment for performing the contract work in conformity with the assembly drawings furnished to it December 30, 1971. In substance, if not in *haec verba*, plaintiff characterizes the administrative decision to the contrary as arbitrary, capricious, and unsupported by substantial evidence. That argument must be, and is, rejected.

While there is some conflict in the administrative record as to what plaintiff's representatives told defendant's representatives, the Board carefully considered the entire record and found therefrom that plaintiff had failed to prove "it had manifested, prior to final contract payment, a positive intention to assert a claim as a matter of legal right either to the contracting officer or one empowered to act for him in such matters."

The words just quoted reflect both factual findings and legal determinations. The factual underpinnings of the administrative decision are, on this record, plainly entitled to finality. *Pelliccia* v. *United States*, 208 Ct. Cl. 278, 294–95, 525 F. 2d 1035, 1045 (1975); *Hoel-Steffen Constr. Co.* v. *United States*, 197 Ct. Cl. 561, 568–69, 456 F. 2d 760, 765 (1972). Plaintiff has failed to show that the Board's findings are in any way arbitrary, capricious, or unsupported by substantial evidence. *Id.* Nor has plaintiff established that the Board decision was in any way legally erroneous. Thus, the administrative legal conclusions, while not binding, also deserve to be sustained.

The contract's Changes clause "contains a time limitation within which a contractor must assert his claims—30 days for actual changes, a reasonable period of time for constructive changes, and in any event no later than the date of 'final payment.'" *Historical Services, Inc.*, DOT CAB Nos. 72–8, 72–8A, 72–2 BCA ¶9592 (and authorities there cited). In the constructive change situation, notice of the claim need not be presented "within the specific number of days allowed" by the Changes clause, but "the filing of a claim within the period of administration of the contract" is

plainly a requisite. *Eggers & Higgins* v. *United States*, *supra*, 185 Ct. Cl. at 785, 403 F. 2d at 236; see also *Specialty Assembling & Packing Co.* v. *United States*, 174 Ct. Cl. 153, 179–80, 355 F. 2d 554, 570 (1966).

Where the contracting officer knows, or is properly chargeable with knowledge, that at the time of final payment the contractor is asserting a right to additional compensation, even though formal claim therefor has not been filed, the fact of final payment does not bar consideration of a later formal claim. Nor are any special words or formal means of communications required in presenting a claim for additional compensation. Those doctrines do not help plaintiff, however, since it is clear that, prior to final payment, the contractor must "manifest his present intention to seek recovery under a claim of right. If he does not do so, his claim is lost * * * [citations omitted]." McBride & Wachtel, 4 GOVERNMENT CONTRACTS § 28.200 (1975 ed.).

As this court said in *Specialty Assembling & Packing Co.* v. *United States*, 156 Ct. Cl. 252, 254–55, 298 F. 2d 794, 796 (1962):

> * * * Perhaps a claim registered pursuant to a Changes clause of a government contract need not specify that clause particularly as a basis for relief, but it must bear some of the attributes of a claim itself, purporting to be in the nature of a claim as of legal right as opposed to a request for grace.

An at best ambiguous and casual statement, to one authorized to provide plaintiff only technical assistance, does not amount to a proper assertion of a claim to an equitable adjustment in the contractually prescribed manner, and an administrative decision so holding cannot fairly be termed "in any way erroneous, let alone arbitrary, capricious, or unsupported by the evidence." *Ibid.*

Upon consideration of the facts found by the Board, and entitled to finality here, and the applicable rules of law, the administrative holding that plaintiff's claim for an equitable adjustment pursuant to the Changes clause was not properly asserted prior to final payment was neither arbitrary, capricious, unsupported by substantial evidence, nor legally erroneous. Accordingly, plaintiff's petition seeking reversal of that decision should be dismissed.

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536 F. 2d 353

MARION L. BRISCOE and ELIZABETH SUE BRISCOE v. THE UNITED STATES

No. 314–74

ELSIE WEGENHOFT v. THE UNITED STATES

No. 315–74

[Decided June 16, 1976]

ON DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT AS TO PLAINTIFF BRISCOE AND SUMMARY JUDGMENT AS TO PLAINTIFF WEGENHOFT AND PLAINTIFF BRISCOE'S MOTION FOR PARTIAL SUMMARY JUDGMENT AND PLAINTIFF WEGENHOFT'S MOTION FOR SUMMARY JUDGMENT

Taxes; income tax; capital gain v. ordinary income; minerals and mineral interests; economic interest.—Plaintiffs seek refund of income taxes and interest for calendar years 1968 through 1970 in connection with payments they received pursuant to an agreement granting the right to enter upon their lands and remove sand and gravel therefrom, in consideration for a fixed price per cubic yard of sand and gravel removed, subject to an annual minimum payment. The agreement also provided a minimum payment by way of royalty for each acre excavated by the "lessee" for purpose of producing sand and/or gravel. The issue is whether plaintiffs consummated a sale of sand and gravel in place to the lessee and thus whether the mineral payments, as plaintiffs contend, should be taxed as capital gain or taxed as ordinary income, as defendant contends. It is *held* that plaintiffs did not dispose of their entire economic interest in the sand and gravel underlying their fee lands, but retained such an interest by virtue of the leasing arrangement wherein their compensation was dependent upon production. Defendant's motion for partial summary judgment in Case No. 314–74 and for summary judgment in Case No. 315–74 is allowed, and plaintiffs' cross-motions are denied. The petition in No. 315–74 is dismissed. The petition in No. 314–74 is dismissed in part and the case is remanded to the Trial Division for further proceedings.

Taxes; income tax; capital gains and losses; minerals and mineral interests.

[1] A "sale" of minerals in place does not take place for purposes of Sec. 1222 of the Internal Revenue Code of 1954 where, incident to the transaction viewed in its totality, the transferor stops short

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of entirely alienating his property and retains an economic interest therein.

Internal Revenue ⟸ 409.10

Taxes; income tax; capital gains and losses; minerals and mineral interests; economic interest.

[2] The test of whether a taxpayer is possessed of an economic interest in minerals in place is whether (1) by legal relationship he has acquired an interest therein and (2) must look *solely* to the extraction of the minerals for a return of capital.

Internal Revenue ⟸ 409.10

Taxes; income tax; capital gain v. ordinary income; minerals and mineral interests; economic interest.

[3] A transaction granting the right to enter upon a taxpayer's land and mine natural resources is not usually considered to be a severance and sale of capital assets warranting capital gains treatment, the taxpayer ordinarily retaining an economic interest in the resources if the consideration received is tied to the production thereof. An advance minimum annual royalty or bonus to be paid without regard to whether minerals were ever extracted does not lead inevitably to the conclusion that a taxpayer looks other than to production for return of capital. Such payment does not defeat the taxpayer's economic interest. Furthermore, a minimum payment calculated by reference to the number of acres excavated does not change this result since such payment amounts to *royalty*, i.e. compensation paid in respect of taxpayer's interest in *minerals* underlying the land, and does not differ from the minimum advance and production royalties.

Internal Revenue ⟸ 409.10

Taxes; form v. substance of transaction.

[4] The parties' denomination of their relationship as that of lessor and lessee in an agreement relating to mining of natural resources from taxpayers' land, does not bind the court, but such language may properly be taken into account in tending to validate the court's basic conclusion that taxpayers intended to and did retain an economic interest in the resources in place in the land to which they retained title.

Internal Revenue ⟸ 409.10

Melvin M. Engel for plaintiff. *Rudy M. Groom*, attorney of record. *Engel, Groom, Miglicco & Gibson*, of counsel.

Joan Seitz Pate, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Robert S. Watkins*, of counsel.

Before DURFEE, *Senior Judge*, NICHOLS and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

Plaintiffs in these tax refund cases place before us the much-litigated ultimate question of whether gain realized from certain mineral payments may be characterized for income tax purposes as proceeds from the sale of capital assets,[1] or must be taken into account as ordinary income subject to an allowance for depletion.[2] In *Briscoe* v. *United States*, Ct. Cl. No. 314–74, the parties cross-move for partial summary judgment only since other issues remain outstanding between them. In *Wegenhoft* v. *United States*, Ct. Cl. No. 315–74, the parties seek disposition of the entire controversy on cross-motions for summary judgment. Because we disagree with the position advanced by the plaintiffs in each of these cases, we allow the Government's motion for partial summary judgment in No. 314–74 and its motion for summary judgment in the companion case, No. 315–74. Plaintiffs' corresponding cross-motions are denied, the petition in No. 314–74 being dismissed insofar as it claims entitlement to refund based on erroneous denial of capital gains treatment for these mineral payments, and the petition in No. 315–74 being dismissed altogether.

Plaintiffs are individuals who during their taxable years 1968 through 1970 owned in fee certain farm- and ranchlands under which were situated extensive deposits of sand and gravel. Plaintiff Elizabeth Sue Briscoe owned 624.96 acres outright, together with an undivided one-half interest in the minerals underlying an additional 383.46 surface acres owned in fee by her mother, plaintiff Elsie Wegenhoft. By instrument styled an "option lease contract" dated July 21, 1966, plaintiff Wegenhoft as "lessor" granted to Gifford-Hill &

[1] Int. Rev. Code of 1954, § 1222(3), provides:

"The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income."

[2] Section 611 of the Code allows as a deduction in computing taxable income a reasonable allowance for depletion of natural resources. Section 613 limits the amount of such deduction to a percentage of the gross income from the property exclusive of rents or royalties paid or incurred by the taxpayer. The maximum "percentage depletion" authorized in the case of sand and gravel is 5 percent. § 613(b)(6)(A).

Company, Inc., as "lessee" an exclusive option to enter into a sand and gravel lease covering the entire acreage just mentioned. The option was exercisable for 180 days by written notice to the lessor. The option lease contract specified the terms of the proposed sand and gravel lease in some detail and when Gifford-Hill exercised the option on October 20, 1966, by written notice and payment of $20,000 as an agreed "advance royalty," a species of mineral lease came into existence for a term of 4 years and for such further period as sand or gravel could be produced in paying quantities.

Paragraph 2 of the sand and gravel lease originally provided that the lessee would pay to the lessor $0.15 per cubic yard as royalty for sand and gravel removed and sold, subject to a minimum of $20,000 per year after production was commenced. Paragraph 4 went on to specify payment of an "advance royalty" in the amount of $20,000, which would be due as previously indicated on the date the option was exercised and thereafter on the anniversary date of such exercise until operations were begun. When production commenced, paragraph 2 would become operative and supersede the advance royalty provisions of paragraph 4. Advance royalties were to be deducted from earned royalties after such commencement, but it was agreed that in no event should the lessor receive less than $20,000 per year during the life of the contract.

Paragraph 8 of the lease contained a further minimum payment provision, which stated that notwithstanding any other paragraph in the agreement, the lessee promised to pay to the lessor "by way of royalty either prepaid or actual at least $1,500 per acre for each lease acre or fraction thereof *excavated* by the lessee for the purpose of producing sand and/or gravel." [Emphasis added.] In other words, without regard to whether mineral actually was removed and sold from each acre or part of an acre excavated, a total minimum payment would be due the lessor as royalty in the amount of $1,500 times the number of acres or parts thereof excavated.[3]

[3] This provision we think of sufficient importance to set it out in full here: "Anything in this contract to the contrary notwithstanding, it is hereby agreed that the Lessee herein will pay to the Lessor herein by way of royalty

(Continued)

On March 28, 1968, plaintiffs Wegenhoft and Briscoe, together as lessors, and Gifford-Hill as lessee, executed an amendment to the sand and gravel lease. The term was extended to a total of 9 years and thereafter for so long as sand or gravel could be produced in paying quantities. Additionally, the parties agreed in amending paragraph 2 that the base price for mineral removed and sold, $0.15, would prevail only until January 1, 1975, whereupon the royalty rate would be adjusted to equal a percentage of the sale price prevailing for calendar year 1974. The amendment provided for revision of this production royalty on each 5-year anniversary date after January 1, 1975, for so long as the lessor might continue operations on the lessors' property. At no time, however, would the royalty be less than $0.15 per cubic yard. Paragraph 4 of the lease was altered so that beginning October 31, 1968, advance royalty payments would be raised to $50,000 per year, with all earned royalties from the sale of sand or gravel in excess of $50,000 per year to be credited to advance royalties paid to that date by the lessee. From and after October 31, 1975, the lessors would receive royalty only on 50 percent of all production from the sale of sand or gravel each year, in no event, however, to fall below $50,000 per year from the date of amendment, October 31, 1968. The amended lease retained without change the minimum royalty provision set out in paragraph 8 of the original lease.[4]

As stated, in these cases we deal with taxpayers' taxable years 1968, 1969, and 1970. During each of those years the record reveals that the taxpayers received and apportioned ratably between them the $50,000 advance royalty only, the lessee not then having gone into production on the lessors' property. Accordingly, under paragraph 8 of the original and amended lease during the disputed years there was no occasion to calculate the minimum royalty that might otherwise have become due to the taxpayers by reference to the

(Continued)
either prepaid or actual, at least Fifteen Hundred ($1,500.00) Dollars per acre for each lease acre or a fraction thereof which is excavated by Lessee for the purpose of producing sand and/or gravel. On the termination of this lease for any cause, Lessee will survey that portion of the land actually excavated. Should earned royalties be less than $1,500.00 times the number of excavated acres then Lessee will pay the Lessor the amount due."

[4] See note 3, *supra*.

amount of land excavated. On these facts taxpayers seek to characterize their royalty receipts as the proceeds of a sale of sand and gravel in place. Defendant resists this approach, urging upon us the position that at no time did the taxpayers dispose of their entire economic interest in a manner as would allow them to take these payments into account as capital gain.[5]

The solution to these cases depends upon the correct answer to the question of whether the taxpayers in the above-described transactions consummated a sale of sand and gravel in place to Gifford-Hill.[6] It has long been settled in cases such as this that a "sale" does not take place for purposes of section 1222 where, incident to the transaction viewed in its totality, the transferor stops short of entirely alienating his property and retains what has come to be known as an "economic interest" therein. *Burnet* v. *Harmel*, 287 U.S. 103, 107 (1932); *Palmer* v. *Bender*, 287 U.S. 551, 556–57 (1933). The general rule is well stated in *Hartman Tobacco Co.* v. *United States*, 471 F. 2d 1327, 1328 (2d Cir. 1973):

> The mining of natural resources is not usually considered to be a severance and sale of capital assets warranting capital gains treatment. In such situations, the taxpayer will ordinarily retain an economic interest in the resources and the transaction will not amount to a sale. Broadly speaking, the taxpayer will retain an economic interest in the resources if the consideration he receives is tied to the production of the resource. However, a taxpayer can receive capital gains treatment if there is a complete and total alienation of his entire interest.

See also, *e.g.*, *Laudenslager* v. *C.I.R.*, 305 F. 2d 686, 690 (3d Cir. 1962), *cert. denied*, 371 U.S. 497 (1963). One court has gone so far as to say that whenever a landowner enters into a "typical" mineral lease with another for the purpose of exploiting natural deposits, there is a reservation of the economic interest in minerals in place and therefore no sale. *Wood* v. *United States*, 377 F. 2d 300, 305 (5th Cir.), *cert. denied*, 389 U.S. 977 (1967).

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[5] This contention accords generally with the view of the Internal Revenue Service as set forth in Rev. Rul. 69–466, 1969–2 CUM. BULL. 140.

[6] The Government has chosen not to deny that the sand and gravel in place occupied the category of "capital asset" within the meaning of section 1221.

In *Palmer* v. *Bender*, *supra*, the Supreme Court first identified the elements of an economic interest:

> * * * The language of the statute is broad enough to provide * * * for every case in which the taxpayer has acquired, by investment, any interest in the * * * [mineral] in place, and secures, by any form of legal relationship, income derived from the extraction of the * * * [mineral], to which he must look for a return of his capital. [287 U.S. at 557.]

The issue in *Palmer* was whether the taxpayer was entitled to a percentage depletion allowance, and not whether capital gains treatment could be accorded to the proceeds of a mineral lease. But since that time courts have recognized that the economic interest concept provides the frame of reference in both lines of decisions. *E.g.*, *Wood* v. *United States*, *supra* at 305, and cases cited therein. As distilled in the authorities in this and in other courts, the test of whether a taxpayer is possessed of an economic interest is whether the taxpayer (1) by legal relationship has acquired an interest in the minerals in place, and (2) must look *solely* to the extraction of the mineral for a return of capital. *Commissioner* v. *Southwest Expl. Co.*, 350 U.S. 308, 314 (1956); *Anderson* v. *Helvering*, 310 U.S. 404 (1940); *Helvering* v. *Elbe Oil Land Dev. Co.*, 303 U.S. 372 (1938); *Food Mach. & Chem. Corp.* v. *United States*, 177 Ct. Cl. 219, 223, 366 F. 2d 1007, 1009 (1966); *National Steel Corp.* v. *United States*, 176 Ct. Cl. 952, 967, 364 F. 2d 375, 383 (1966); *Handelman* v. *United States*, 174 Ct. Cl. 1042, 1055, 357 F. 2d 694, 702 (1966).[7]

The taxpayers do not dispute that prior to the transactions outlined herein they possessed an investment in the mineral in place—the first element of an economic interest. However, they deny that after the various agreements took effect, payments thereunder necessarily would come solely from the extraction of sand and gravel. Taxpayers draw our attention first to the requirement of a minimum annual royalty, either actual or advance, of $20,000 (later amended to $50,000). They argue that since these payments would be and were in fact forthcoming without regard to whether a single cubic yard of mineral ever was extracted, their payments were

[7] *See generally* W. B. Wood, *Sale v. Sublease*, 1964 N.Y.U. 22d Inst. on Fed. Tax. 1343.

not realized *solely* from the extraction of the minerals in question. We need not be detained by this position, however, since the Supreme Court already has authoritatively disapproved it in *Burnet* v. *Harmel*, *supra* at 112.

More persuasively, taxpayers contend that paragraph 8 of the original and amended lease (imposing a minimum royalty calculated by reference to the number of acres excavated) impels the conclusion that they were not required to look solely to actual extraction of sand and gravel for a return of their capital. Without regard to whether or not any mineral was extracted, it is said, for each acre excavated a minimum payment of $1,500 would be made. Thus, taxpayers could look to mere excavation of land for a return, not solely to extraction.

Before stating the reasons for our disagreement with taxpayers' construction of paragraph 8, we deem it advisable to explore for a moment the decisions where it has been held that a taxpayer lacks an economic interest unless required to look solely to extraction or production of mineral for a return of investment. In *Southwest Expl. Co.*, *supra*, this aspect of the economic interest test was not seriously disputed, 350 U.S. at 314, but the Court did refer to the *Elbe* and *Anderson* decisions as precedent therefor. In *Elbe*, the taxpayer sought a tax refund asserting that it was erroneously denied a depletion deduction. Taxpayer had conveyed oil and gas prospecting permits, drilling agreements, leases and equipment to another corporation. The grantee in return agreed to pay $350,000 on execution of their agreement, $400,000 per year for each of the years 1928 through 1930, and $450,000 for 1931. Moreover, the grantee promised to pay the taxpayer monthly one-third of the net profits resulting from production and operation. The agreement recited that full ownership and control of the property transferred was vested in the grantee, taxpayer having no interest therein. On these facts, the Court held that the taxpayer was not entitled to a depletion allowance, because it disposed of its entire depletable or economic interest in the mineral in place. It was said:

> * * * The aggregate sum of $2,000,000 was paid as an agreed purchase price to which was to be added the one-third of the net profits payable on the conditions speci-

> fied. We are unable to conclude that the provision for this additional payment qualified in any way the effect of the transaction as an absolute sale or was other than a personal covenant of the * * * [grantee]. * * *. [303 U.S. at 375.]

In the later *Southwest Expl. Co.* case, the true basis of the *Elbe* decision was said to be that the payments were not "dependent on production." 350 U.S. at 314. We think the *Elbe* Court was influenced as well by the stated intent of the parties to the effect that the transaction should be regarded as having divested the taxpayer of all interest in the property and rights conveyed. 303 U.S. at 374–75. In any event, the taxpayer did not have to look *solely* to extraction for a return of capital. It looked primarily to the unconditional contractual obligation of the grantee to pay $2,000,000 for the entire package of rights and assets transferred, and then to a "personal covenant" to pay over a share of profits.

Anderson v. *Helvering*, *supra*, provides a more useful statement of the requirement that the holder of an economic interest in minerals looks solely to production for his return. There, two individual taxpayers acquired from a corporation certain royalty interests, fee interests, and deferred oil payments. The vendees agreed to pay a total price of $160,000 (1) $50,000 upon execution, and (2) $110,000 deferred purchase money payable with interest. The deferred purchase price was to come from two sources: (a) from one-half of the proceeds received by the vendees from production, and (b) from the proceeds of resales by the vendees of the fee interests originally conferred upon them by their vendor. During their taxable year 1932 the individual taxpayers received from production some $81,000, one-half of which they deposited in a bank to the credit of the vendor in accordance with the agreement. The one-half so paid to the vendor the taxpayers did not report as income to them, whereupon the Commissioner assessed a deficiency. The Court agreed with the Government that the amounts so received were includible in the gross income of the vendees, saying:

> It is settled that the same basic issue determines both to whom income derived from the production of oil and gas is taxable and to whom a deduction for depletion is allowable. That issue is, who has a capital investment in

> the oil and gas in place and what is the extent of his interest. [Citations omitted.] [310 U.S. at 407.]

Thus, following the basic rule that income from property is taxable to the owner thereof, the Court set about determining whether the investment in the minerals in place was in the individual taxpayer or, rather, in the corporate vendor. Observing that the vendor corporation could look beyond production for its return—to resales of fee interests by the taxpayers—it was concluded that the vendor was "not dependent entirely upon the production of oil for the deferred payments," 310 U.S. at 412, and therefore not eligible for a depletion deduction with respect to income from such resales. Accordingly, the depletable interest and the capital investment in the minerals in place had to be situated in the individual vendees, and income derived from resales thus was includible in the gross income of those taxpayers.

The principle which the reader discovers upon examination of *Elbe* and *Anderson* does indeed appear to be that unless one looks solely to production or extraction of minerals for a return of invested capital, one has no depletable or economic interest in such minerals. The Supreme Court has reasoned in part that income generated from sources other than production, *e.g.*, from resales of fee interests, does not necessarily result in physical depletion of the natural resources. *Anderson*, *supra*, 310 U.S. at 412. In such a case for tax purposes no depletion allowance is warranted. As in *Anderson*, one who looks other than solely to production for a return generally has disposed of the entire interest in minerals. Thus, the court in *Rhodes* v. *United States*, 464 F. 2d 1307 (5th Cir. 1972), alluded to a contract term calling for a firm price of $7,500 per acre for merchantable brick clay as disuasive of the conclusion that the taxpayer looked exclusively to production for income. We declined to reduce a depletion allowance in *Food Mach. & Chem. Corp.* v. *United States*, *supra*, finding that the taxpayer's transferor in that case derived its return from payment for mining services rendered and not solely from production. The entire economic interest therefore devolved upon the taxpayer. In *Bel* v. *United States*, 160 F. Supp. 360 (W.D. La. 1958), the taxpayer was allowed capital gains treatment for the payments in dispute because as vendor of

sand and gravel beneath specific land he had taken back the vendee's unconditional promissory notes to which he could look for his return. The obligations evidenced by the notes in no way depended on production. He had severed his investment totally and the court so held. Similarly in *Robert M. Dann*, 30 T.C. 499 (1958), the vendor of fill dirt was permitted capital gains treatment for sales proceeds, because he looked not to production but solely to contractual rights against the buyers of the dirt. *Id.* at 506. *Accord*, *Wayman A. Collins*, 56 T.C. 1074 (1971). In *Gowans* v. *Commissioner*, 246 F. 2d 448 (9th Cir. 1957), the court approved capital gains treatment finding a sale of sand in place, observing that the taxpayer looked not only to production for income, but also "received substantial compensation wholly unrelated to sand withdrawals," 246 F. 2d at 452, in the form of a house, and grading, paving, and pipe laying services. Where one derives income other than solely from extraction or production of minerals, generally he has disposed of his economic interest in minerals in place. If such disposition amounts to a "sale" and other prerequisites are met, capital gains treatment is authorized.

We believe that these taxpayers looked solely to production or extraction for their return within the rules announced in the above-referenced authorities. First we reiterate that an advance minimum royalty or bonus payment does not lead inevitably to the conclusion that a taxpayer looks other than to production for a return of capital. Such a payment does not defeat the taxpayers' economic interest. *Burnet* v. *Harmel*, *supra*. But more importantly for purposes of the present cases, the minimum payment provisions of paragraph 8 in these agreements do not change the result. Taxpayers' error in construing that paragraph lies in supposing that it requires the lessee to pay $1,500 each and every time a single shovel of dirt is turned over on any acre of the taxpayers' land. We may assume without deciding that this interpretation would induce us to agree that payments did not depend solely on production, but rather in part on mere excavation. A closer reading of the words in paragraph 8, however, makes it abundantly clear to us that the $1,500 per acre

minimum payment amounts to *royalty; i.e.*, compensation paid in respect of the taxpayers' interest in *minerals* underlying the entire tract. In principle the per acre minimum figure does not differ from the minimum advance and production royalties specified in other paragraphs of the lease. The parties to that instrument have agreed that notwithstanding the minimum calculated on the basis of production or otherwise, the total of royalty payments to be received by taxpayers over the life of the lease will in no event fall below the yardstick figure of $1,500 multiplied by the total number of acres or fractions of acres excavated for the purpose of extracting sand and/or gravel. If this interpretation were incorrect and that of the taxpayer accepted, the words "by way of royalty either prepaid or actual," and the entire final sentence of paragraph 8 would be utterly without meaning, contrary to settled rules of construction. If a minimum advance royalty or bonus does not cause a taxpayer to look to something other than production for a return, *Burnet* v. *Harmel*, *supra*, then neither does the minimum in the instant cases which is calculated by reference to acreage.[8]

Aside from our basic economic interest approach in these cases, other factors appear upon examination of the record which point to the absence of the sale which is so critical to the capital gain characterization now sought by taxpayers. Taxpayers and Gifford-Hill denominated their relationship as that of lessor and lessee. At no time do any of the various writings before us speak of a sale of sand or gravel by plaintiffs to their lessee. While the language selected for an agreement does not bind us, we think it may properly be taken into account as tending to validate our basic conclusion that taxpayers intended to and did retain an economic interest in the minerals in place in the land to which they retained title. *See Vest* v. *C.I.R.*, 481 F. 2d 238 (5th Cir., *cert. denied*, 414 U.S. 1092 (1973); *Rhodes* v. *United States*, *supra*. Moreover, the parties to such agreements defined the compensation run-

[8] Although the matter was not thoroughly discussed, a "minimum royalty of $2000 per acre for each acre used, stripped or damaged" in limestone operations failed to convince one court that the taxpayers looked other than solely to production. *Belknap* v. *United States*, 406 F. 2d 737, 738 (6th Cir. 1969).

ning to plaintiffs as "royalty." One court sitting en banc thought this terminology under the weight of authority in both hard mineral and oil and gas cases to be inherently incompatible with treatment of a mineral payment as the proceeds of a sale. *United States* v. *White*, 401 F. 2d 610, 614 (10th Cir. 1968).

The court finds as a matter of law that the plaintiffs did not dispose of their entire economic interests in the sand and gravel underlying their fee lands, but retained such an interest by virtue of a leasing arrangement with Gifford-Hill wherein their compensation was dependent upon production. Because of this conclusion, defendant's motion for partial summary judgment in No. 314–74 and for summary judgment in No. 315–74 is allowed and the plaintiffs' cross-motions are denied. The petition in No. 315–74 is dismissed. The petition in No. 314–74 is dismissed in part and that case is remanded to the Trial Division for further proceedings consistent with this opinion.

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544 F. 2d 468

CHARLES E. CRAFT v. THE UNITED STATES

[No. 96–74. Decided June 16, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Military pay; temporary disability retiree; disability retirement; final determinations of Physical Evaluation Board and Review Council; restoration to rank; reenlistment date and length of period.—Plaintiff enlisted in the Army in 1952. Beginning in 1959 he served a tour of duty in Germany and later in Vietnam, returning in January 1968 to Fort Bragg. Following complaints by plaintiff's wife to his superiors about his attitude concerning her fidelity, he was hospitalized for observation. The examining psychiatrist concluded that plaintiff suffered from a schizophrenic reaction and was unfit for retention in the Army; based solely on this report a Medical Board and a Physical Evaluation Board found plaintiff unfit for retention, the latter recommending that plaintiff be placed on the Temporary Disability Retired List (TDL) with a 70% disability rating. This recommendation was concurred in by a Physical Review Council, and on May 28, 1969 plaintiff was placed on the TDL. Plaintiff was not interviewed by any of these boards. After 3 years on the TDL plaintiff submitted

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to additional medical examinations and in compliance with applicable statutes the Army conducted a reevaluation to determine plaintiff's fitness for duty. The examining psychiatrist concluded that plaintiff was fit for return to duty, but that, because of plaintiff's bitterness toward the Army, reinstatement was precluded, and he recommended permanent discharge. A reevaluation Medical Board, without interviewing plaintiff and without making a determination of his fitness concurred in the psychiatrist's separation recommendation. A Physical Evaluation Board, following a hearing accorded plaintiff, found the latter fit to perform the duties of his rank. However, the Physical Review Council overturned this recommendation based on the same record and without a hearing, and without a statement of reasons for this action. A Physical Disability Appeal Board summarily affirmed the Council without a hearing and on the same record. On May 31, 1973 plaintiff was permanently separated for disability. Plaintiff seeks reinstatement, back pay and records correction, contending that the initial findings of disability leading to placement on the TDL and the reevaluation Council's reversal were arbitrary and capricious and violative of Army Regulations. It is *held* that the decision of the Council finding plaintiff unfit to return to duty from the TDL is not sustainable. The decision failed to enumerate the reasons for modifying the determination of the reevaluation Physical Evaluation Board. There is no record evidence to support a finding that the Council's reversal comported with the narrow standards required by the regulations for overturning Evaluation Boards. However, there is substantial record evidence to support the conclusion of the Physical Evaluation Board that plaintiff was fit to perform the duties of his rank. Plaintiff should have been reenlisted under the requirements of 10 U.S.C. § 1211. The court emphasizes that the holding is not based upon its opinion of plaintiff's fitness, but upon a review of the applicable administrative decisions. Plaintiff's motion for summary judgment is granted and defendant's cross-motion is denied. Plaintiff is entitled to recover and judgment is entered to that effect with the amount of recovery to be determined in further proceedings. The Secretary of the Army is ordered to reenlist plaintiff (with his consent) in the rank he occupied on May 28, 1969 for a period at least equal to 3 years, 5 months and 25 days, effective May 31, 1973, and to correct plaintiff's applicable records consistent with the opinion.

Military pay; retired pay (disability); Physical Review Boards and Council.

[1] Where an Army Physical Review Council reversed a Physical Review Board which found plaintiff fit to perform the duties of his rank, and the Council was affirmed by a Physical Disability Appeal Board, both without a hearing and on the same record and

absent an adequate statement of reasons for said reversal, since the Appeal Board failed to remedy the Council's defects the decision of the former must rise or fall with that of the Council which is the central key component of the decisional process.

Armed Services ⇐ 23.4(1)

Military pay; Court of Claims jurisdiction; retired pay (disability). [2] Generally, in the military disability retirement area, the Court of Claims is limited to determining whether the action of the military in finding a member unfit for service is arbitrary, capricious, unsupported by substantial evidence or contrary to applicable statutes and regulations.

Courts ⇐ 449(1)

Military pay; retired pay (disability); regulations of executive department; binding effect of regulations; administrative boards and officials.

[3] In order to afford the requisite finality to administrative decisions in the military retirement area, the decisional authorities must discuss, in writing, the reasons for their action. In overturning a recommendation of a Physical Evaluation Board, an unelaborated conclusion of a Physical Review Council having nothing to do with the member's current physical condition as found by the Board does not rise to the dignity of "reasons" contemplated and required by Army Reg. 635–40, ¶ 5–5. Such a conclusion, without an analysis of the evidence in writing does not afford adequate assurance to the member or the court that due weight was given to all of the evidence.

Armed Services ⇐ 23.4(1)

Military pay; retired pay (disability); Physical Review Council; reasons for adverse action of Council; necessity for giving. [4] A decision of a Physical Review Council which failed to give reasons for reversing a reevaluation Physical Evaluation Board composed of a doctor and a member of the Medical Corps which found plaintiff fit to perform the duties of his rank based on evidence and plaintiff's appearance before the Board, cannot be said to comport with Army Reg. 635–40, ¶ 5–5a, where a search of the record by the court fails to show the instances set forth in the regulation when a Council may modify the findings and recommendations of an Evaluation Board. Since the court has before it the determination of the reevaluation Physical Evaluation Board based on evidence and reasons, it may apply its traditional standards of review to such determination in order to test plaintiff's fitness for duty and need not remand the case for further evidence.

Armed Services ⇐ 23.4(1)

Military pay; retired pay (disability); Retiring or Physical Evaluation Board determination; evidence.

[5] In the revaluation of the fitness of a temporary disability retiree, evidence before the Army Physical Evaluation Board of

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a clinical report of an Army chief psychiatrist that plaintiff was fit for duty, letters from private medical and nonmedical sources supporting a fitness determination, as well as evidence that plaintiff had adapted well to civilian life by maintaining an excellent employment record after placement on the Temporary Disability Retired List, and the fact that the Board and its medical member had an opportunity to observe plaintiff when he appeared before the Board, are relevant to the reevaluation process.

Armed Services ⇐ 23.4(1)

Military pay; retired pay (disability); Retiring or Physical Evaluation Board; temporary disability retiree; examining physician prognosis.

[6] A report of an examining physician as to a serviceman's fitness for return to active service may include a prognosis, but may not contain gratuitous conclusions of law or references to final disposition of a serviceman on the Temporary Disability Retired List.

Armed Services ⇐ 23.4(1)

Military pay; retired pay (disability); temporary disability retiree; final determination of status.

[7] The fact that plaintiff was placed on the Temporary Disability Retired List following an unfitness determination is of dubious relevance in the reevaluation process. It is only the condition which exists at the time of reevaluation by the Physical Evaluation Board that is pertinent as to whether a serviceman is fit to return to duty.

Armed Services ⇐ 23.4(1)

Military pay; retired pay (disability); temporary disability retiree; final determination of status; validity of determination.

[8] The test used to measure the validity of a conclusion of the reevaluation Physical Evaluation Board that a temporary disability retiree is fit to return to duty is whether the conclusion is based on substantial evidence viewed against the record as a whole.

Armed Services ⇐ 23.4(1)

Military pay; retired pay (disability); temporary disability retiree; final determination of physical fitness; restoration to active duty.

[9] Where it has been determined that a temporary disability retiree is fit to perform his duty, under 10 U.S.C. § 1211(a)(3) Congress has mandated that he "shall be reenlisted." Thus, while reenlistment usually is a matter within the discretion of the Secretary of a given military branch, under the circumstances here, the court is compelled to apply Sec. 1211(a)(3) and return plaintiff to active duty.

Armed Services ⇐ 23.4(1)

Military pay; restoration to rank; temporary disability retiree; date and length of reenlistment period.

[10] Where plaintiff who had been placed on the Temporary Disability Retired List on May 28, 1969, was improperly discharged by

the Army on May 31, 1973 as permanently unfit for duty, plaintiff should have been reenlisted on the latter date for a period at least equivalent to the time remaining on his contract of reenlistment as of May 28, 1969. While plaintiff is entitled to be reenlisted in the grade he occupied on May 28, 1969, 10 U.S.C. § 1211(a)(3) permits the Secretary of the Service, in his discretion, to reenlist plaintiff in the next higher grade.

Armed Services ⇐ 23.4(2)

David Rein, attorney of record for plaintiff.

Russell W. Koskinen, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, DAVIS, and KUNZIG, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

In this military pay case of first impression, plaintiff, a former U.S. Army Special Forces Sergeant First Class (SFC, E–7), seeks reinstatement, back pay and records correction. SFC Craft contests the action of the Army in placing him on the Temporary Disability Retired List (the Temporary List) in 1969 and also the Army's subsequent decision permanently to retire him for disability in 1973. We are unanimously of the opinion that plaintiff's 1973 permanent separation cannot stand and we hold for plaintiff.

On January 18, 1952, plaintiff enlisted in the Army. After basic training at Ford Ord, plaintiff volunteered for airborne training and on completion of jump school, the Army assigned him to Fort Bragg. In 1959, SFC Craft served a tour of duty in Germany and by 1961 had returned to Fort Bragg. During this second Fort Bragg assignment, plaintiff volunteered for the Special Forces. While with this unit, SFC Craft participated in the Vietnam conflict in 1967 where, in the words of his commanding officer, he performed missions of an "extremely hazardous nature." The history of plaintiff's military career, particularly in Vietnam, clearly illustrates that he was, in all respects, an excellent soldier.

In January 1968, plaintiff returned to Fort Bragg from Vietnam and his problems with the Army began. Strangely, it was not plaintiff's duty performance, but marital difficulties which led to his current predicament. Plaintiff's wife

complained to his commanding officer and base medical personnel about Craft's attitude concerning her fidelity. On January 17, 1969, Fort Bragg authorities admitted plaintiff to Womack Army Hospital, ostensibly for a three-day observation. The examining psychiatrist, a Captain Rabon, concluded that plaintiff suffered from a "[s]chizophrenic reaction, paranoid type, chronic, [and] severe * * *." Rabon recommended that a Medical Board find Craft unfit for retention in the Army despite the fact that the only impaired relationship demonstrated by Craft involved his wife. Whatever the nature of plaintiff's condition, there is no evidence in the record that it interfered with his military duties.

As a result of Rabon's recommendation, Womack personnel did not release plaintiff at the end of the three-day period, but confined him to a locked mental ward until the latter part of March. At this time, Craft was transferred to an open ward until his April 15, 1969, release from the hospital.

In the meantime, a Medical Board convened at Fort Bragg to evaluate plaintiff's case. Based solely on CPT Rabon's recommendation, the Medical Board on February 26, 1969, found plaintiff unfit for retention. Plaintiff did not appear before this Board.

The diagnosis was reviewed by a Physical Evaluation Board at Fort Gordon. The Evaluation Board found plaintiff unfit and recommended that he be placed on the Temporary List with a 70 percent disability rating. Like the Medical Board, the Evaluation Board formulated its conclusions without interviewing plaintiff and based its findings on the report of CPT Rabon.

On April 28, 1969, the Army denied plaintiff's request for a disability waiver to remain on active duty. A Physical Review Council reconsidered his medical status and concurred with the recommendations of the Evaluation Board again without seeing plaintiff. The Council rendered its decision on May 1, 1969. On May 28, 1969, the Adjutant General placed plaintiff on the Temporary List.

By mid-1969, plaintiff found himself in temporary retirement based on his wife's complaints and the January 1969 examination by CPT Rabon. Plaintiff in his desire for "vindication," proceeded to seek private legal and medical advice.

In 1972, plaintiff submitted to additional examinations and administrative proceedings calculated to gauge his fitness for duty after three years on the Temporary List. The statutes which establish the Temporary List define this procedure. The nature of this status is a type of "limbo." A serviceman who is on the List is separated from the Army, but his final status is deferred pending additional medical evidence. 10 U.S.C. § 1202 (1970). When a party is placed on the List, he is to receive periodic examinations and the Secretary of the service branch must, within five years, make a final disposition of the case. 10 U.S.C. § 1210 (1970). The final determination takes two forms. The serviceman is either found unfit to return to duty in which case he is permanently retired, or he is found fit and must be returned to active service (with his consent). 10 U.S.C. §§ 1210–11 (1970). *See* Part 3, *infra*. Therefore, in compliance with these statutes, the Army conducted a reevaluation of plaintiff's situation in 1972 and 1973.

During the first step of the reevaluation, SFC Craft was examined by LTC Stoller, Chief Psychiatrist at Madigan Hospital, Tacoma, Washington. On September 20, 1972, Colonel Stoller concluded that plaintiff was *fit for return to duty*. However, Stoller noted that plaintiff's bitterness toward the Army precluded consideration of any reinstatement. Stoller recommended a permanent discharge.

A reevaluation Medical Board convened to assess Stoller's diagnosis. This Board, *without making a determination of plaintiff's fitness*, concurred in LTC Stoller's separation recommendation. Plaintiff did not appear before the reevaluation Medical Board.

This led to proceedings before a Physical Evaluation Board (the reevaluation PEB). This Board at first considered SFC Craft's case solely on the record. *Again, without making a fitness determination*, the reevaluation PEB recommended separation. However, it reconsidered and granted plaintiff a hearing. After listening to plaintiff's testimony and having an opportunity to observe his demeanor, the reevaluation PEB on February 13, 1973, found plaintiff "*fit to perform the duties of* [*his*] * * * *rank*."

Having come this close to his goal of return to active duty, plaintiff had two more hurdles to surmount. The first of these was a Physical Review Council (the Council). On February 21, 1973 only a week after the reevaluation PEB report, the Council overturned the reevaluation PEB without a hearing and based on the same record that the PEB had used when concluding that Craft was fit for duty. Moreover, the sum total of changes effected by the Council under the heading "modifications and reasons" was as follows:

> The following modification(s) and reasons therefore have been made in your case:
> Items:
> 8a(1): Enter: "9203."
> 8b(1): Enter: "schizophrenic reaction, paranoid type, chronic, slight."
> 8c(1): Enter: "No."
> 8d(1) and 8e(1): Enter: "Yes."
> 8g(1): Enter: "10."
> Delete check under "Fit." Check: "Unfit." Enter: "10" and "Separated with severence pay."
> 10: Check: "Is not."

A physical Disability Appeal Board reviewed the case on April 10, 1973. Again, without a hearing and on the same record, the Board affirmed the Council. The reasons given were limited to the following statement:

> [T]he board finds that the findings and recommendations of the Physical Evaluation Board as modified by the *Army Physical Review Council* are supported by the evidence of record, are correct in fact and are in accordance with Department of the Army policies pertaining to physical fitness and/or physical separation or retirement.

On May 31, 1973, plaintiff was permanently separated from the Army for disability.

Whatever the medical evidence reveals, one fact in the instant case becomes astonishingly clear upon careful examination of the record. Plaintiff was permanently retired from the Army for mental disability without any evidence of impairment of his duty performance. It is against this background that plaintiff brings the instant action seeking reinstatement, back pay and records correction.

Plaintiff now enters a motion for summary judgment. First, he argues that the initial findings of disability leading to placement on the Temporary List were arbitrary, capricious and in violation of Army Regulation 40–501, ¶ 3–29 (defining the standards for a finding of psychotic disability). Second, plaintiff contends that the reevaluation proceedings were invalid. Specifically, he attacks the Council's determination overturning the PEB. Craft says that the Council's reversal was arbitrary, capricious, not supported by evidence, invalid for failure to state reasons and in contravention of Army Regulation 635–40, ¶ 5–5, which narrowly defines the situations in which the Council may reverse a Physical Evaluation Board. Third, plaintiff claims that the Army's conduct violated 10 U.S.C. § 1169 (1970) (circumscribing the occasions when a military serviceman may be discharged before the termination of his service contract).

Defendant counters with a cross-motion for summary judgment. It asserts that the initial unfitness determination was not arbitrary or capricious and conformed with the applicable regulations. Second, defendant contends there was no reversible error in the reevaluation proceedings. Third, it argues that the Court of Claims has no power to restore plaintiff to active duty or make a fitness determination and plaintiff cannot recover. Finally, the Government relies on the affirmative defense that plaintiff cannot recover to the extent that he seeks pay and allowances for the period after expiration of his enlistment contract. The crux of defendant's arguments is that we must leave plaintiff as we find him.

Based on the record, we conclude that the reversal by the Council [1] cannot be permitted to stand. We, therefore, hold that plaintiff is entitled to recover.[2]

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[1] The later summary affirmance of the Council by the Appeals Board also failed to state adequate reasons for the reversal of the PEB. The Council is the "central key component of the decisional process." *Cooper* v. *United States*, 178 Ct. Cl. 277, 316 (1967). Since the Appeals Board failed to remedy the Council's defects, its decision must rise or fall with that of the Council. Therefore, our discussion of the Council's determination will hereinafter be deemed to include that of the Appeals Board, although not specifically referring to the Board by name.

[2] Since we render judgment for plaintiff based on an invalid decision of the reevaluation Council, we find it unnecessary to address plaintiff's attacks on the initial unfitness determination (plaintiff's point 1) and his argument that 10 U.S.C. § 1169 (1970) prevents his separation (plaintiff's point 3).

1. The Council

a. Standard for Review

We begin our analysis of plaintiff's discharge by considering the proper standards for review of administrative actions. As a general rule in the disability retirement area, the court is limited to determining whether the action of the military is arbitrary, capricious, unsupported by substantial evidence or contrary to applicable statutes and regulations. *See, e.g., Newman* v. *United States*, 185 Ct. Cl. 269, 276 (1968); *Beckham* v. *United States*, 183 Ct. Cl. 628, 635–36, 392 F. 2d 619, 622 (1968); *Smith* v. *United States*, 168 Ct. Cl. 545, 553 (1964). As expressed by the court in *Harris* v. *United States*, 177 Ct. Cl. 538 (1966):

> * * * [T]he traditional role of the court on review 'is to determine not whether the claimant was unfit for service at the time of his release, but rather whether the finding of the Secretary * * * that the serviceman was fit was so arbitrary, capricious or unsupported by evidence as to be contrary to the applicable principles of law.' *Johnston* v. *United States*, 157 Ct. Cl. 474 (1962). [*Id.* at 541].

In the case at bar, we must review the determination made by the Council by use of these standards. Since this decision cannot be upheld, we must then assess the findings of the reevaluation PEB in order to determine what the Army should have done with SFC Craft's case.

b. Reasons Given by Council for Reversal

During the reevaluation process, the Council overturned the determination made by the PEB. The PEB had decided in favor of plaintiff. The Council's modification provides few, if any, reasons for its action.[3] Plaintiff contends that

[3] In addition to some nondescript words "filling in the blanks," the Council added a few other phrases in the midst of a percentage disability paragraph.

> "A careful review of the original medical board reveals that the external precipitating stress of your schizophrenic condition was routine military life. It is not felt that a possible return to this stress is an appropriate disposition of your case, and that you are, in fact, "unfit" for continued military service."

A conclusion of this type, having nothing to do with plaintiff's current physical condition as found by the PEB, can hardly rise to the dignity of "reasons" contemplated by the regulations and case law.

the failure to provide sufficient reasons affords adequate grounds to negate the actions of the Council. We agree.

First, the regulations required the Council to give a summary of reasons for its action. Army Regulation 635–40, ¶ 5–5, permits the Council to modify or reverse the findings of a Physical Evaluation Board in certain limited situations. *See* Part I.c., *infra*. However, the same regulation mandates that in order to take such action, the Council must furnish a *summary of the reasons* for the modification.[4]

> If the APRC [Army Physical Review Council] revises the recommendations of a PEB [Physical Evaluation Board] * * * *the following actions will be accomplished*:
>
> (1) A copy of the revised recommendations will be furnished the member. * * * The revised recommendations *will include a summary of the reasons thereof.* * * * [Army Regulation 635–40, ¶ 5–5c(1) (emphasis added)].

Moreover, we have in the past held that in order to afford the requisite finality to administrative decisions in the military retirement area, boards must discuss, in writing, the reasons for their action. The court noted in *Beckham*, *supra*:

> A *naked conclusion* and mere recitation that the opinion is based upon all of the evidence without an analysis of the evidence in writing * * * *is inimical to a rational system of administrative determination and ultimately inadequate.* * * * 'In these circumstances [summary and sketchy findings and reasoning by the administrative Board] we cannot give as much deference to the Board's determination as if it had given detailed findings, to support, and fuller explanations of the reason for, its conclusion. * * * [*Id.*, 183 Ct. Cl. at 636, 392 F. 2d at 622–23 (emphasis added, citations omitted)].

In a particularly egregious situation, the court may be compelled to conduct its own inquiry in order to find record sup-

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[4] That the requirement for reasons is absolutely mandatory is further evidenced by the regulations:

> "When APRC [Council] revised recommendations differ from those of the PEB and provide for a change in disposition of the member being evaluated * * * procedures described in paragraph 5–5 [including a summary of reasons] *will be followed.*" [Army Regulation 635–40, ¶ 5–4 (5)(b) (emphasis added)].

port for the administration decision. As stated in *Smith*, *supra*:

> Where the medical issue is complex and in considerable dispute, and the Veterans Administration has previously found [in favor of plaintiff] * * * a disposition of the claim * * * by the * * * Board without a hearing and *without an analysis of the evidence in writing is inadequate assurance that due weight was given to all of the evidence.* * * * [*Id.*, 168 Ct. Cl. at 553 (emphasis added)].

In short, the Council, based on the requirements of case law and regulations, had a duty to present a summary of reasons for reversing the favorable (to plaintiff) decision of the reevaluation PEB. Absent such reasons, we cannot sustain their conclusions.

In *Versaci* v. *United States*, 185 Ct. Cl. 672, 403 F. 2d 246 (1968), the court was confronted with a similar situation. In that case, an Army Physical Review Council suddenly, and without explaining its reasons, reversed a decision by a Physical Evaluation Board. The reasons for the reversal could not be supplied from the record. The court declined to sustain the Council's determination.

> Such a determination, "conclusionary in nature," making it impossible to "determine what weight was given to the evidence," and which does not "discuss the details or specify precisely what items of evidence were considered," cannot be sustained. [*Id.*, 185 Ct. Cl. at 691, 403 F. 2d at 256].

We note at this juncture that there is nothing burdensome about the requirement that the Council give reasons for its actions. The reasons need not be expressed in great detail. *Harris*, *supra*, 177 Ct. Cl. at 545–46. All that is required is sufficient notification to the serviceman to permit him, if he may, to rebut the board's action. *Imhoff* v. *United States*, 177 Ct. Cl. 1, 8 (1966), *cert. denied*, 389 U.S. 844 (1967).

On the other hand, it is important to realize the dangers that failure to provide appropriate reasons can produce. Faced with an administrative decision adverse to him, a soldier needs to be sufficiently informed of the basic grounds of that adverse decision in order adequately to appeal.

Applying the necessity for giving reasons to the case at bar, it becomes patently clear that the Council failed to meet the requirement. The Council's letter to plaintiff merely stated the alterations to the reevaluation PEB's findings and told plaintiff what appeal rights were available. It did not *discuss* the reasons for the modifications. Plaintiff was left in the dark as to the basis for the unfavorable decision. In such circumstances, we cannot sustain the conclusions of the Council.

c. When the Council May Reverse

The failure to give reasons in the instant case becomes even more reprehensible in light of the regulations which carefully limit the situations when a Council may modify or reverse the findings of a Physical Evaluation Board. Since the Council failed to provide its reasons for reversing the PEB, there is no way the court can determine whether the basis for reversal comported with these regulations.

> The APRC [Council] may modify the findings and recommendations [of an Evaluation Board] when—
>
> (1) There is *manifest error* on the face of the record, or
>
> (2) The *evidence* in the record is so clear and compelling as to *require revision*, or
>
> (3) Accepted *medical principles* preclude a reasonable possibility of the correctness of the PEB findings and recommendations. [Army Regulation 635–40, ¶ 5–5a (emphasis added)].

In the instant case, the Council's failure to delineate reasons compels the court to search the record to support the reversal based on one of the three reasons outlined in the regulations. *Beckham*, *supra*; *Smith*, *supra*. A careful search of the record fails to show that any of the three reasons subject to the review of this court is involved in the case at bar.

The reevaluation PEB had before it substantial evidence of plaintiff's fitness for duty. *See* Part 2, *infra*. Moreover, *plaintiff appeared before this Board*, affording it the opportunity to observe his demeanor and mental state. A vital member of the reevaluation PEB was a doctor and a member of the Medical Corps. The only contrary evidence before the

PEB was LTC Stoller's observation that plaintiff was bitter toward the Army, and the record of plaintiff's initial diagnosis almost four years earlier. And even LTC Stoller had found plaintiff fit for active duty.

Given such circumstances, we cannot say that the decision of the reevaluation PEB measured against the standards of Army Regulation 635–40, ¶ 5–5a was: (1) based on manifest error; (2) contrary to evidence of record; or (3) precluded by accepted medical principles. The court may not make its own *de novo* fitness determination. *Orloff* v. *Willoughby*, 345 U.S. 83, 91 (1953). If the only decision in the record were that of the Council, we might be forced to remand the case for further evidence and adequate reasons. However, the record before the court contains the decision of the reevaluation PEB. We can apply our traditional standards of review to the PEB's determination in order to test plaintiff's fitness for duty.

2. The Reevaluation PEB

The reevaluation PEB found plaintiff fit to perform the duties of his rank. There is substantial evidence in the record to support such a determination.

The reevaluation PEB had before it the military's clinical report by Chief Psychiatrist LTC Stoller to the effect that plaintiff was fit for duty. It had private letters and recommendations from plaintiff's Army associates supporting a fitness determination. There were also letters from a private psychiatrist indicating that plaintiff was fit. The PEB had before it, evidence that plaintiff had adapted well to civilian life by maintaining an excellent employment record after his placement on the Temporary List. Such evidence is relevant in the reevaluation process. *Merson* v. *United States*, 185 Ct. Cl. 48, 59, 401 F. 2d 184, 190 (1968); *Hoppock* v. *United States*, 176 Ct. Cl. 1147, 1165–66 (1966); *Farrar* v. *United States*, 173 Ct. Cl. 1008, 358 F. 2d 965 (1965). Finally, but perhaps most important, is the fact that the PEB, including its medical member, had an opportunity for a firsthand analysis of plaintiff's fitness because plaintiff appeared before the Board.

Balanced against the evidence before the PEB in plaintiff's favor is the statement of LTC Stoller that SFC Craft should not be considered for reinstatement because he was bitter toward the Army, coupled with the record of the 1969 diagnosis leading to plaintiff's placement on the Temporary List. Not only does the favorable evidence appear to be overwhelming contrasted with these two negative items, there is every indication that the negative items could not even be considered by the PEB. A report of an examining physician may include a prognosis, but may not contain gratuitous conclusions of law or references to final disposition of servicemen on the Temporary List. *Cf. Storey* v. *United States*, 209 Ct. Cl. 174, 531 F. 2d 985 (1976). As such, LTC Stoller's "bitterness" remark seems irrelevant to plaintiff's fitness determination. Moreover, if bitterness toward a Service is a sufficient basis for separation, the military might be inundated with retirement requests.

In addition, the record of the 1969 unfitness determination leading to plaintiff's placement on the Temporary List, is also of dubious relevance in the reevaluation process. At oral argument, defense counsel claimed that under Army Regulation 40–501, once a soldier is found to be psychotic, such condition is deemed to be permanent. Such argument cannot be upheld. First, a belief that once a person has mental problems he will always have such problems contains little basis in reality. Although psychiatry is not an exact science, there are numerous examples of recovery from mental illness. Second, the regulation does not encase a serviceman's mental disability in stone. It merely provides:

> [Disability separation is provided for:] Recurrent psychotic episodes, existing symptoms or residuals thereof, or a recent history of psychotic reaction sufficient to interfere with performance of duty or with social adjustment. [Army Regulation 40–501, ¶ 3–29].

Third, defendant's interpretation of the effect of mental illness would seem to be at odds with the philosophy of the Army. The Army placed plaintiff on the Temporary List rather than permanently retiring him, apparently in the be-

lief that he could recover from whatever problems he had. Finally, defendant's argument is legally incorrect. The prior record of unfitness is of little, if any, relevancy, in the reevaluation process. "[I]t is only the condition which exists at the time of removal from the [Temporary] list that is pertinent." *Versaci*, *supra*, 185 Ct. Cl. at 685, 403 F. 2d at 253; *Nolte* v. *United States*, 177 Ct. Cl. 1069 (1966). In short, the question before the reevaluation PEB was whether plaintiff, *at the time of the PEB's consideration*, was fit to return to duty.

The test used to measure the validity of the PEB conclusion that plaintiff was fit to return to duty is whether it is based on substantial evidence viewed against the record as a whole. *Brozik* v. *United States*, 180 Ct. Cl. 546 (1967). Based on the present record, the only determination we can make is that there *is* substantial evidence supporting the PEB's determination. Since the decision reversing the PEB cannot be sustained, *see* Part 1, *supra*, we are compelled to concur with the PEB that plaintiff was, in fact, fit to return to duty. We so hold.

3. The Remedies

Given the fact that plaintiff was fit to return to duty, we must then determine what such a decision portends. Plaintiff's petition seeks reinstatement, back pay and records correction. Defendant counters that we cannot reinstate plaintiff or order back pay because of the nature of Craft's enlistment contract. However, both plaintiff and defendant mistake the nature of the Temporary List and the impact of a decision that a serviceman is fit to return to duty.

When on the temporary retired disability list, a serviceman is actually separated from the military. During this limbo status, the soldier receives disability pay. His situation is reevaluated at periodic intervals, and eventually a permanent decision is made. If the serviceman is found to be unfit, he will be permanenty retired from the military. 10 U.S.C. § 1210 (1970). However, if the soldier is found fit for duty, the remedy is somewhat unusual, and its application here, to the best of our knowledge, is a matter of first impres-

sion. 10 U.S.C. § 1211 (1970) governs this instance and specifies:

> § 1211. *Members on temporary disability retired list: return to active duty; promotion*
>
> (a) With his consent, any member of the Army or the Air Force whose name is on the temporary disability retired list, and who is *found to be physically fit to perform the duties of his* office, grade or *rank* under section 1210(f) of this title [periodic examinations], *shall*—
>
> (3) *if an enlisted member* of a regular component, *be reenlisted in the regular grade held by him* when his name was placed on the temporary disability retired list *or in the next higher* regular enlisted *grade.*
>
> [10 U.S.C. § 1211(a)(3) (1970)].

Under this statute, a serviceman found fit to perform his duties must be reenlisted.[5]

We realize that this situation is somewhat unique. Normally, reenlistment is a matter within the discretion of the Secretary of a given military branch. *See, e.g., Savio* v. *United States*, 207 Ct. Cl. 1039 (1975); *Austin* v. *United States*, 206 Ct. Cl. 719, *cert. denied*, 423 U.S. 911 (1975); *O'Callahan* v. *United States*, 196 Ct. Cl. 556, 451 F. 2d 1390 (1971). However, in the case where an individual on the temporary disability retired list is found fit to return to duty, Congress has mandated that he "shall be reenlisted." This directive obviously proves of benefit both to the Government (in retaining quality military personnel) and to the individual concerned (in completing his active service in order to obtain retirement benefits).

In the case at bar, having determined that the unfavorable decision of the Council cannot be sustained and finding substantial evidence in the record to support the conclusion of the PEB that plaintiff was fit to perform the duties of his rank, we are compelled to apply 10 U.S.C. § 1211(a)(3) (1970) and restore plaintiff to active duty.

Finally, the sole remaining questions concern the date of the mandatory reenlistment and the length of such reenlist-

[5] Army Regulation 635–40, ¶ 7–11(b) mirrors the statute.

ment period. The statute and regulations are silent as to such questions.

The Army, on May 31, 1973, improperly discharged plaintiff as permanently unfit for duty. Given the fact that plaintiff was fit to return to duty, we hold that plaintiff should have been reenlisted on this date instead of separated. Further, we determine that plaintiff was entitled to be reenlisted for a period at least equivalent to the time remaining on his contract when he was placed on the Temporary List. Plaintiff's latest reenlistment was for a period of six years on November 23, 1966. He had served two years, six months and six days at the time he was placed on the Temporary List, and some three years, five months and twenty-five days remained on this reenlistment contract. Therefore, we hold that the Army should have reenlisted plaintiff on May 31, 1973, for at least three years, five months, and twenty-five days. Such a term would expire in November 1976.

In summary, we cannot sustain the decision of the Council finding plaintiff unfit to return to duty from the temporary retired disability list. This unfavorable decision failed to enumerate the reasons for modifying a determination by the reevaluation PEB that plaintiff was fit to return to duty, and there is no evidence in the record upon which we can find that the Council's reversal comported with the narrow standards required by the regulations for overturning Evaluation Boards. On the other hand, there is substantial evidence in the record to support the conclusion of the PEB that plaintiff was fit to perform the duties of his rank. Plaintiff should have been reenlisted in the Army under the requirements of 10 U.S.C. § 1211, rather than separated. We reemphasize that our holding is not based upon the court's opinion of plaintiff's fitness, but upon our review of the applicable administrative decisions.

Accordingly, for the reasons stated above, plaintiff's motion for summary judgment is granted and defendant's cross-motion is denied. Plaintiff is entitled to recover on his claim and judgment is entered to that effect with the amount of recovery to be determined pursuant to our Rule 131(c). The Secretary of the Army is ordered to reenlist plaintiff

(with his consent) in the rank of Sergeant First Class, E–7, for a period at least equal to three years, five months and twenty-five days, effective May 31, 1973, and to correct plaintiff's applicable records consistent with this opinion, pursuant to Rule 147(c) of the Rules of this court.[6]

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536 F. 2d 930

MOTOR COACH INDUSTRIES, INC. v. THE UNITED STATES

[No. 51–74. Decided June 16, 1976]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; manufacturers excise tax; automotive parts or accessories; air conditioning systems.—Plaintiff manufactures and sells three models of motor buses, all equipped with air-conditioning systems, of which the major items were manufactured by an unrelated company, designed to provide a comfortable atmosphere for passengers by supplying cooled, filtered, and dehumidified fresh and recirculated air through wall ducts. The systems consist of components, some custom built, which are distributed throughout the buses in predesigned spaces; each system is designed solely for use in the particular bus model in which it is installed. Plaintiff filed Federal manufacturers excise tax returns and paid the reported taxes for the quarterly periods beginning January 1, 1966 and ending December 31, 1970, based upon the sales price of the buses complete with air-conditioning systems. Thereafter plaintiff filed claims for said tax years seeking refund of that portion of the excise taxes paid attributable to the installed air-conditioning systems. Following disallowance of the claims or the elapsing of 6 months from the filing thereof, plaintiff filed its present suit seeking to recover the said portion of the excise taxes. Plaintiff relies on the decisions in *Thermo King Corp.* v. *United States*, 173 Ct. Cl. 860, 354 F. 2d 242 (1965), and *U.S. Thermo Control Co.* v. *United States*, 178 Ct. Cl. 561, 372 F. 2d 964, *cert. denied*, 389 U.S. 839 (1967), which held that the refrigerating units in suit there were not taxable as automotive parts or accessories under the 1932 law, were properly taxed as commercial refrigeration units under the 1941 law, and with repeal of the latter law in 1942

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[6] Plaintiff is *entitled* to be reenlisted in the grade Sergeant First Class (E–7). However, we feel compelled to note that the statute which grants the right to such reenlistment also permits the Secretary, in his discretion, to reenlist plaintiff in *the next higher grade*. 10 U.S.C. § 1211(a)(3)(1970).

Syllabus

did not become subject to the excise tax on the sale of automotive parts or accessories. It is *held* that the system viewed as a whole is properly characterized as an air-conditioning system and not as a refrigeration system, and as such is taxable under Sec. 4061(a) of the Internal Revenue Code of 1954 as parts or accessories sold in connection with automobile buses. Therefore, *Thermo King* is not available to plaintiff to remove it from the parts or accessories tax provision. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

Taxes; excise tax; manufacturers excise tax; automotive parts or accessories; refrigerators, refrigerating apparatus and air-conditioners.

[1] Since subsection (b) of the 1941 amendments to Sec. 3405 of the Internal Revenue Code of 1939 imposed a tax only upon the enumerated refrigerating components sold by the manufacturer, producer or importer thereof, such components would not have been taxable to plaintiff under subsection (b) because plaintiff is not the manufacturer thereof.

Internal Revenue ⇐ 1143

Taxes; excise tax; manufacturers excise tax; automotive parts or accessories; refrigerating units.

[2] While S.T. 523, XI–2 Cum. Bull. 477 (1932), exempted "refrigerating units for commercial transportation equipment" from excise taxation prior to enactment of the 1941 provisions of Sec. 3405 of the Internal Revenue Code of 1939, this ruling cannot fairly be read to have exempted air-conditioning of buses, trucks, etc. from taxation at a time when the application of air-conditioning to the transportation industry was essentially nonexistent. If "refrigerating units" covered "air-conditioners," it would be superfluous for Congress to separately provide a tax on each in the same 1941 statute.

Internal Revenue ⇐ 1143

Statutes; construction and operation; titles or headings.

[3] While titles or headings of statutes cannot limit the plain meaning of the text, they are to be considered in resolving ambiguity.

Statutes ⇐ 126

Taxes; excise tax; manufacturers excise tax; automotive parts or accessories; air-conditioning system for buses.

[4] Where the systems here in issue were designed solely for use in buses, they were installed in predesigned spaces, and they not only cooled but filtered and dehumidified fresh and recirculated air which is distributed through wall ducts to meet the requirements of the bus, such systems viewed as a whole are properly characterized as air-conditioning systems taxable under Sec. 4061(a) of the Internal Revenue Code of 1954 as automotive parts or acces-

sories. They are not "refrigerating units" or "refrigerators" (as those terms were used administratively in 1932 and legislatively in 1941) and, therefore, they are not taxable under subsection (a) of the 1941 excise tax provisions.

Internal Revenue ⇐ 1143

Robert H. Kapp, attorney of record, for plaintiff. *Seymour S. Mintz*, *Gail S. Marshall*, *Hogan & Hartson*, *Ralph J. Wehling*, of counsel.

Kenneth R. Boiarsky, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

Before SKELTON, KASHIWA, and KUNZIG, *Judges*.

KASHIWA, Judge, delivered the opinion of the court:

This is a suit for the recovery of federal excise taxes paid for the period commencing January 1, 1966, and ending December 31, 1970.

The case is before this court on cross motions for summary judgment. We find that there is no genuine issue as to any material fact. We hold for the defendant for reasons hereafter stated.

Plaintiff, Motor Coach Industries, Inc., a Delaware corporation, is a wholly owned subsidiary of The Greyhound Corporation. Plaintiff is, and at all relevant times has been, engaged in the manufacture and sale of motor buses. During the period from January 1, 1966, through December 31, 1970, plaintiff sold motor buses equipped with air-conditioning systems which were designed to provide a comfortable and healthful atmosphere for passengers within the coach by supplying cooled, filtered, and dehumidified fresh and recirculated air through wall ducts located below the side windows. During that period plaintiff sold basically three different intercity bus models, the model MC–5A, the model MC–6, and the model MC–7. Built-in air-conditioning systems were provided as standard equipment on these models. These air-conditioning systems consist of components, some of which are custom built, which are distributed throughout

the bus in spaces predesigned for this purpose; and each system is designed solely for use in the particular bus model in which it is installed.

Plaintiff filed federal manufacturers excise tax returns for each of the quarterly periods from January 1, 1966, through December 31, 1970, and paid the taxes reported due thereon. The reported excise taxes were computed based upon the sales price of the buses complete with air-conditioning systems. Claims for refund were thereafter filed for each of the calendar years 1966 through 1970, seeking the recovery of that portion of the excise taxes paid which was attributable to the air-conditioning systems installed in the buses sold. Following the formal disallowance of those claims by the Internal Revenue Service or the elapsing of six months from the filing thereof, plaintiff's petition was filed on February 7, 1974.

The sole question presented is whether air-conditioning systems installed on automobile buses manufactured and sold by plaintiff during the period in issue were subject to the manufacturers excise tax on automotive parts and accessories imposed by § 4061(a) of the Internal Revenue Code of 1954.[1]

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[1]During the taxable periods here in issue, § 4061(a)(1) and (b)(1) of the Internal Revenue Code of 1954 provided as follows:

"(a) *Automobiles.*—There is hereby imposed upon the following articles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof) sold by the manufacturer, producer, or importer a tax equivalent to the specified percent of the price for which so sold:

"(1) Articles taxable at 10 percent, except that on and after October 1, 1972, the rate shall be 5 percent—

Automobile truck chassis.
Automobile truck bodies.
Automobile bus chassis.
Automobile bus bodies.
Truck and bus trailer and semitrailer chassis.
Truck and bus trailer and semitrailer bodies.
Tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.

"A sale of an automobile truck, bus, truck or bus trailer or semitrailer shall, for the purposes of this paragraph, be considered to be a sale of a chassis and of a body enumerated in this paragraph.

* * * * *

"(b) *Parts and Accessories.*—

"(1) Except as provided in paragraph (2), there is hereby imposed upon parts or accessories (other than tires and inner tubes) for any of the articles

(Continued)

It appears on casual reading that the air-conditioning systems in question are taxable under § 4061(a) because they are "parts or accessories" and because they were "sold on * * * Automobile bus bodies." There is no dispute that the air-conditioning systems here in issue were sold on plaintiff's buses. As for their qualification as "parts or accessories," we note that § 48.4061(b)-2(a) (1963), Treasury Regulations on Manufacturers and Retailers Excise Taxes, reads as follows:[2]

> (a) *In general.* The term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or other automobile chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use. * * *

Defendant argues that because (1) air conditioning was sold on taxpayer's buses as a system, (2) the component parts were built in, custom fitted, or specifically designed primarily for use in bus air-conditioning systems, and (3) these systems

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(Continued)
enumerated in subsection (a)(1) sold by the manufacturer, producer, or importer a tax equivalent to 8 percent of the price for which so sold, except that on and after October 1, 1972, the rate shall be 5 percent." [P. L. 91-605, Dec. 31, 1970, § 303(a) (3), (4), 84 Stat. 1713, 1743-44, substituted 1977 for 1972.]

We observe that express inclusion of buses in the automotive statute was made in 1941 by § 544 of the Revenue Act of 1941, ch. 412, 55 Stat. 687, 711-712. For the statutes prior to this, see Revenue Act of 1918, ch. 18, § 900, 40 Stat. 1057, 1122; Revenue Act of 1921, ch. 136, § 900, 42 Stat. 227, 291; Revenue Act of 1924, ch. 234, § 600, 43 Stat. 253, 322; Revenue Act of 1926, ch. 27, § 600(1), 44 Stat. 9, 93-94, repealed by Revenue Act of 1928, ch. 852, § 421, 45 Stat. 791, 865; Revenue Act of 1932, ch. 209, § 606, 47 Stat. 169, 261-63, amended by Act of June 16, 1933, ch. 90, § 212, 48 Stat. 195, 206, by Act of June 28, 1935, ch. 333, 49 Stat. 431 by Act of June 29, 1937, ch. 402, 50 Stat. 358, and by Revenue Act of 1938, ch. 289, § 709, 52 Stat. 447, 571; Internal Revenue Code of 1939, ch. 29, § 3403, 53 Stat. 410.

[2] Essentially, this definition of parts or accessories has remained unchanged in pertinent part since 1919 (Treas. Reg. 47 (Revenue Act of 1918), Articles 15 and 16, revised in 1920 and 1924; Treas. Reg. 46 (Revenue Act of 1932), Article 41; and Treas. Reg. 46 (Internal Revenue Code of 1939), § 316.55 (1940)); the definition was specifically held valid by the Supreme Court in 1930 in *Universal Battery Co.* v. *United States*, 281 U.S. 580.

were designed to provide a comfortable atmosphere for bus passengers, they clearly constitute parts or accessories. Moreover, defendant argues that the regulations expressly include "Automobile air conditioners" as the first example given of taxable parts or accessories in § 48.4061(b)–2(d).[3] See, also, Rev. Rul. 56–544, 1956–2 Cum. Bull. 797 (where automobile air conditioners sold with a taxable motor vehicle were held, in the first published position by the Internal Revenue Service, to be subject to tax under § 4061(a)); for later rulings expressly holding bus air conditioners to be subject to the parts and accessories tax, see Rev. Rul. 63–23, 1963–1 Cum. Bull. 206, 207, and Rev. Rul. 69–578, 1969–2 Cum. Bull. 199.

Since, as above shown, it appears that plaintiff's bus air-conditioning systems fall within the language of § 4061(a) and Treas. Reg. § 48.4061(b)–2(a), *supra*, imposing a tax on parts or accessories sold with buses, the issue should be one of easy solution. But, as shown in the discussion to follow, the solution is not without problems because of plaintiff's arguments based on prior decisions of this court in *Thermo King Corp.* v. *United States*, 173 Ct. Cl. 860, 354 F. 2d 242 (1965), and *U.S. Thermo Control Co.* v. *United States*, 178 Ct. Cl. 561, 372 F. 2d 964, *cert. denied*, 389 U.S. 839 (1967).

At this point we shall discuss *Thermo King Corp.* v. *United United States*, *supra*.[4] In that case the taxpayer sued to recover manufacturers excise taxes paid on the sales of commercial refrigeration units designed to cool the interiors of commercial trucks on the ground that such sales were not taxable under § 4061(b), Int. Rev. Code of 1954, as automotive parts or accessories. It is significant that the taxpayer was a manufacturer of the refrigeration units and unlike plaintiff in the present case, it was not the manufacturer of

[3] "(d) *Examples of articles taxable as parts or accessories.* Examples of articles which are taxable as parts or accessories are: *Automobile air conditioners;* * * * automobile radio antennae; automobile license plate frames; automobile clocks; automobile mirrors and mirror brackets; * * *." [Emphasis supplied.] The list is long and covers many types of parts and accessories.

[4] *Thermo King* was the substantive case and we shall discuss it as the main case, though both it and *U.S. Thermo Control Co.* v. *United States*, *supra*, stand for the same proposition.

the trucks in which they were placed. The taxpayer stated that from the enactment in 1932 of an excise tax on automotive parts and accessories until 1941, the sale of truck refrigeration units was not subject to any excise tax. The Revenue Act of 1941 taxed commercial refrigeration units and the taxpayer paid the excise tax. In 1942 this provision was repealed. The taxpayer no longer paid the tax until 1945 when the Internal Revenue Service ruled that truck refrigeration units were taxable as automotive parts or accessories rather than as commercial refrigeration units. The Government asserted that the truck refrigeration units were always subject to the tax on automotive parts or accessories and were never intended to be included under the 1941 tax on commercial refrigeration. The court concluded that the sales of this equipment by the taxpayer were not taxable as sales of automotive parts or accessories under § 606 of the Revenue Act of 1932 as amended and that they were taxable under § 546 of the Revenue Act of 1941 during the period October 1, 1941, to November 1, 1942. As to whether it was taxable after November 1, 1942, the court stated:

> Under the doctrine established in *United States* v. *Leslie Salt Co.*, 350 U.S. 383 (1956), and *J. P. Seeburg Piano Co.* v. *United States*, 62 Ct. Cl. 281 (1926), an article subject to tax under a specifically applicable provision, *viz*, refrigerators or refrigerator units, where there was at the same time a more general provision argued as applicable, and the provision to which the article was specifically subject is repealed, the article does not become taxable under the more general provision, *in the absence of an explicit statement of Congressional purpose that it be so taxable.*
>
> * * * * *
>
> The rules stated in the *Leslie Salt Co.* and *Seeburg Piano Co.* cases, *supra*, apply even more forcefully where the general statute (Automotive Parts and Accessories) predated the repealed specific statute (Commercial Refrigeration Equipment) and the general statute was interpreted and administered as not covering the specific subject before the repeal of the specific statute.
>
> We conclude finally that the 1942 repeal of the 1941 tax on Commercial Refrigeration ended plaintiff's tax liability under the facts in this case, and that plaintiff

is entitled to recover on its petition. [173 Ct. Cl. at 873 and 875, 354 F. 2d at 249 and 251.]

Thermo King was incorporated into a revenue ruling, Rev. Rul. 68–136, 1968–1 Cum. Bull. 453,[5] wherein the Internal Revenue Service held, at 454, that sales of "refrigeration units designed to be installed in taxable truck or trailer bodies" are not subject to the automotive excise tax on parts or accessories; and the Internal Revenue Service further stated at 454:

> The conclusions expressed in this Revenue Ruling are applicable only to refrigeration units designed to be installed in taxable truck or trailer bodies. These conclusions are not to be extended so as to exclude from manufacturers excise tax any other article (1) the sale of which is within the scope of section 4061(b)(1) of the Code, or (2) properly includible in the tax base for sales of chassis and bodies subject to the tax imposed by section 4061(a).

Since *Thermo King* is based on § 3405, we shall now discuss the provisions of § 3405, as amended in 1941, and their nonapplicability to plaintiff's bus air-conditioning systems. We shall also refer to this section in other parts of this opinion as the 1941 provisions. Section 3405 of the Internal Revenue Code of 1939, as amended by § 546 of the Revenue Act of 1941, ch. 412, 55 Stat. 687, 713, and prior to its amendment by § 614 of the Revenue Act of 1942, ch. 619, 56 Stat. 798, 978, provided as follows:

> SEC. 3405. TAX ON REFRIGERATORS, REFRIGERATING APPARATUS, AND AIR-CONDITIONERS.
>
> There shall be imposed on the following articles (including in each case parts or accesories therefor sold on or in connection with the sale thereof) sold by the

[5] 1968–1 Cum. Bull. at 454:
"In *U.S. Thermo Control Co.* v. *United States* and *Thermo King Corporation* v. *United States*, 372 F. 2d 964 (1967), cert. den. 88 S.C. 68 (1967), the United States Court of Claims concluded that refrigeration units designed to be installed in taxable truck or trailer bodies are not subject to the tax imposed by section 4061(b)(1) of the Code when sold by the manufacturer or importer of the units. In view of this decision, the Internal Revenue Service now holds that sales of such refrigeration units are not subject to the tax imposed on automotive parts and accessories by section 4061(b)(1)."

manufacturer, producer, or importer a tax equivalent to 10 per centum of the price for which so sold:

(a) *Refrigerators, etc.*—Refrigerators, beverage coolers, ice cream cabinets, water coolers, food and beverage display cases, food and beverage storage cabinets, ice making machines, and milk cooler cabinets, each such article having, or being primarily designed for use with, a mechanical refrigerating unit operated by electricity, gas, kerosene, or gasoline.

(b) *Refrigerating Apparatus.*—Compressors, condensers, evaporators, expansion units, absorbers, and controls, for, or suitable for use as part of, or with, a refrigerating plant, refrigerating system, refrigerating equipment or unit, or any of the articles enumerated in subsection (a).

(c) *Air-conditioners.*—Self-contained air-conditioning units.

(d) *Components.*—Cabinets, compressors, condensers, fans, blowers, heating coils, cooling coils, filters, humidifiers, and controls, for, or suitable for use as part of, or with, any of the articles enumerated in subsection (c).

We initially note that the statute, in subsections (c) and (d), provides separately, consistent with the section heading, for the taxability of air conditioners and their components as opposed to refrigerators and refrigerating apparatus. Further, it is clear from this statute that the only air conditioners considered by Congress to be taxable thereunder were "Self-contained air-conditioning units" (subsection (c)) and that the only air-conditioning components within its scope were those for, or suitable for use with or as part of, self-contained air-conditioning units (subsection (d)); the clarity of this legislative intention is emphasized by the fact that subsection (c) is comprehensively entitled "Air-conditioners," followed by the delineation of "Self-contained air-conditioning units" as being the only "Air-conditioners" subject to tax, and the air-conditioning components taxable under subsection (d) include only those for, or suitable for use with or as part of, the "articles enumerated in subsection (c)."

Since the components were distributed througout the bus, they are obviously not self-contained under subsection (c). Plaintiff does not contest this. Since subsection (d) requires components to be suitable for use as part of the self-contained unit mentioned in (c), the components in the present case

are obviously not covered by subsection (d). Plaintiff again does not contest this.

Although plaintiff concedes nontaxability under subsections (c) or (d), it strenuously argues that the items were taxable under subsection (a) or (b). Plaintiff summarizes its position in its brief:

> Thus, the equipment here was taxable under § 3405 because either in its entirety *it constitutes a refrigerator or refrigerating unit* under subsection (a) (substantially identical to the truck refrigeration system held to be taxable under (a) in *Thermo King* and *Thermo Control*) or its component parts became taxable under subsection (b) because they were for, or suitable for, use in a refrigerating system. [Emphasis supplied.]

Defendant agrees with plaintiff that "refrigerating units" and "refrigerators" were properly considered by the court in *Thermo King* to have been taxable under subsection (a) of the 1941 provisions rather than under subsection (b) thereof. Thus, the questions are: (1) whether plaintiff's bus air-conditioning systems would have been taxable as "refrigerating units" or "refrigerators" under subsection (a) of the 1941 provisions and (2) whether the component parts of plaintiff's bus air-conditioning systems would have been taxable under subsection (b) of the 1941 provisions. We shall consider subsection (b) first and thereafter consider subsection (a).

We first observe that subsection (b) of the 1941 provisions imposed a tax only upon refrigerating *components sold by the manufacturer, producer, or importer* thereof. Thus, two points must be made in this regard. First, plaintiff does not sell refrigerating components or apparatus; rather, it sells integrated air-conditioning systems as part of its buses. Second, plaintiff admits that each of the major items of equipment or apparatus were manufactured by Carrier Corporation and not by plaintiff. Section 316.1, Treasury Regulations 46 (1940 ed.), provides that the term "manufacturer" includes "producer" and "importer," and § 316.4 provides that

> * * * The term "manufacturer" includes a person who produces a taxable article from scrap, salvage, or

junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles.

Under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the txable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

A manufacturer who sells a taxable article in a knockdown condition, but complete as to all component parts, is liable for the tax, and not the person who buys, and assembles a taxable article from, such component parts. [Footnotes omitted.]

The "taxable articles" under subsection (b) of the 1941 provisions are the listed components, and none of these components is manufactured by plaintiff. Accordingly, even if plaintiff's air-conditioning systems could be fractionally considered as components, it is our view that those components would not have been taxable to plaintiff under subsection (b) of the 1941 provisions because plaintiff is not the manufacturer thereof.

We now discuss taxability of the items in issue in the present case under subsection (a) of the 1941 provisions.

This court in reaching the *Thermo King* decision placed heavy reliance upon S.T. 523 XI–2 Cum. Bull. 477 (1932), declared obsolete by Rev. Rul. 67–199, 1967–1 Cum. Bull. 390, 393, as having exempted "refrigerating units for commercial transportation equipment" from all excise taxes prior to the enactment of the 1941 provisions. But plaintiff does not deny that the application of *air conditioning* to the transportation industry (including buses, trucks, cars, airplanes, ships, and railway passenger cars) was either not yet in use in 1932 or, in the case of railway passenger cars, was only in early experimental stages.[6] We do not believe that ruling can fairly be read to have exempted transportation air condition-

[6] See the trade publications cited at the end of Chapter 37 (p. 671) of the *Heating Ventilating Air Conditioning Guide 1941*, published by the American Society of Heating and Ventilating Engineers. Also, plaintiff's brief suggests that buses with air conditioners date from approximately 1939.

ing from taxation at a time when the application of air conditioning to the transportation industry was essentially nonexistent. Furthermore, if the term "refrigerating units" as used in that ruling "clearly" covered air conditioners, as plaintiff contends, it is difficult to understand why Congress in 1941, knowing of this fact, would separately provide a tax on "air-conditioners" which is superfluous and redundant if earlier provisions in that same statute intended to tax "refrigerating units." Plaintiff argues that the titles or headings are not properly to be considered in construing the meaning of the 1941 provisions. But, while titles or headings "cannot limit the plain meaning of the text," they are to be considered in resolving ambiguity. *Brotherhood of Railroad Trainmen v. Baltimore & O.R.R.*, 331 U.S. 519, 528–529 (1947); *Maguire* v. *Commissioer*, 313 U.S. 1, 9 (1941).

We now turn to the factual distinctions between plaintiff's bus air-conditioning systems and the refrigeration systems. Plaintiff and defendant have submitted drawing sections, portions of plaintiff's sales literature, affidavits, portions of depositions, and references to definitions and descriptions in standard engineering manuals. We have carefully examined the submissions by the parties. We conclude and find from them that there is no dispute as to any material fact for the resolution of the issue presented in discussion of subsection (a). Although plaintiff's system employs refrigeration components, that fact does not make it a refrigeration system. We find that the system viewed as a whole is properly characterized as an air-conditioning system, and not as a refrigeration system, because the systems here in issue do not just cool; rather, they cool, filter, and dehumidify fresh and recirculating air, which is distributed through wall ducts located below the side windows. We also find that plaintiff's bus air-conditioning systems do contain devices which are designed to control the humidity of the air as well as its temperature, cleanliness, and distribution to meet the requirements of the bus, that those systems do considerably more than refrigerate and cool the air. We, therefore, find they are not "refrigerating units" or "refrigerators" (as those terms were used administratively in 1932 and legis-

latively in 1941). Therefore, they are not taxable under subsection (a) of the 1941 excise tax provisions.

Plaintiff has not shown that the items are taxable under subsection (c) or (d) or under (a) or (b) of § 3405. Therefore, *Thermo King* is not available to plaintiff to remove it from the parts and accessories tax provision. Therefore, the air conditioners involved in this case are taxable under § 4061(a) as parts or accessories sold on or in connection with automobile buses.[7]

CONCLUSION

For the reasons above stated we conclude as a matter of law that defendant's motion for summary judgment is granted, plaintiff's motion for summary judgment is denied, and the petition is dismissed.

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536 F. 2d 918

GENERAL MOTORS CORPORATION v. THE UNITED STATES

[No. 236–73. Decided June 16, 1976]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; manufacturers excise tax; automotive parts or accessories; air-conditioning systems for buses.—Plaintiff seeks to recover Federal excise taxes paid for the period commencing April 1, 1966 and ending December 31, 1966, plus interest. As in *Motor Coach Ind., Inc.* v. *United States*, decided today, *ante* at 188, plaintiff sold buses equipped with air-conditioning systems designed to provide a comfortable atmosphere for passengers by supplying cooled, filtered, and dehumidified fresh and recirculated air through ducts located in the bus. The systems consist of components which are built in,

[7] Plaintiff's final contention, in the alternative, is that the compressor and expansion valve of its bus air-conditioning system are not to be taxed with the air-conditioning system, even though these items are integral and necessary components of that system, because apart from that system these items have a general utility. Plaintiff argues that there is no basis in the regulations for combining the components. However, plaintiff is ignoring the specific regulatory provision that gives automobile air conditioners as the first example of articles taxable as parts or accessories in Treas. Reg. § 48.4061(b)–2(d), *supra*.

custom fitted, or specifically designed primarily for use in the buses and distributed throughout the buses. The major components were manufactured by unrelated manufacturers. Plaintiff relies on the decisions in *Thermo King Corp.* v. *United States*, 173 Ct. Cl. 860, 354 F. 2d 242 (1965), and *U.S. Thermo Control Co.* v. *United States*, 178 Ct. Cl. 561, 372 F. 2d 964, *cert. denied*, 389 U.S. 839 (1967), which held that the refrigerating units in suit there were not taxable as automotive parts or accessories under the 1932 law, were properly taxed as commercial refrigeration units under the 1941 law, and with repeal of the latter law in 1942 did not become subject to the excise tax on the sale of automotive parts or accessories. On the basis of the court's holding in *Motor Coach Ind., Inc.* it is *held* that the systems viewed as a whole are properly characterized as air-conditioning systems and not as refrigeration systems, and not as "refrigeration units" or "refrigerators" (as those terms were used legislatively in 1941). Therefore, they would not have been taxable under subsection (a) of the 1941 excise tax provisions, and are taxable under Sec. 4061 of the Internal Revenue Code of 1954 as parts or accessories sold in connection with automobile buses. Therefore, *Thermo King* is not available to plaintiff to remove it from the parts or accessories tax provision. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

Ronald A. Pearlman, attorney of record, for plaintiff. *Edwin D. Akers*, *Charles M. Babington III*, *Thompson & Mitchell*, *E. Alan Moorhouse*, of counsel.

Kenneth R. Boiarsky, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

Before SKELTON, KASHIWA, and KUNZIG, *Judges*.

KASHIWA, *Judge*, delivered the opinion of the court:

This is a suit for the recovery of federal excise taxes paid for the period commencing April 1, 1966, and ending December 31, 1966, in the aggregate amount of $300,000, plus interest thereon. The case is before the court on cross motions for summary judgment. There is no genuine issue as to any material fact. For the reasons stated below, we hold for the defendant. We have also decided on this date a parallel case in favor of the defendant in *Motor Coach Industries, Inc.* v. *United States*, *ante* at 188.

Plaintiff is a Delaware corporation which at all relevant times has been engaged principally in the manufacture and sale of mechanical, electrical, and other products. Plaintiff's business is conducted through various unincorporated divisions, one of which is the GMC Truck and Coach Division. Among the products manufactured and sold by the GMC Truck and Coach Division are automobile bus chassis and automobile bus bodies.

During the period from April 1, 1966, through December 31, 1966, plaintiff sold buses equipped with air-conditioning systems which were designed to provide passenger comfort by cooling, dehumidifying, and filtering fresh and recirculated air through floor, ceiling, or wall ducts. Buses equipped with air-conditioning systems were first sold by plaintiff in 1939. During the subject period plaintiff sold basically three different types of buses, i.e., transit, suburban, and intercity. Of the bus types sold during this period, approximately 59 per cent, 84 per cent, and 100 per cent, respectively, were equipped with air-conditioning systems. These air-conditioning systems consist of components which are built in, custom fitted, or specifically designed primarily for use in bus air-conditioning systems and which are distributed throughout the bus. Each of the major components were manufactured by other manufacturers and not by plaintiff. The air-conditioning systems installed in plaintiff's buses are neither considered by taxpayer to be "self-contained" nor are they so considered by the industry.

Taxpayer filed federal manufacturers excise tax returns for each of the quarterly periods from April 1, 1966, through December 31, 1966, and paid the taxes reported due thereon. The reported excise taxes were computed based upon the sales price of the buses complete with air-conditioning systems. A claim for refund was thereafter filed on July 31, 1969, seeking the recovery of that portion of the excise taxes paid which was attributable to the air-conditioning systems installed in the buses sold. Following the formal disallowance of that claim by the Internal Revenue Service by letter dated August 13, 1971, the petition was filed on August 6, 1973.

The issue involved here is whether air-conditioning systems installed on automobile buses manufactured by plaintiff and sold during the period in question were subject to the manufacturers excise tax on automotive parts and accessories imposed by § 4061(a) of the Internal Revenue Code of 1954.

During the taxable periods here in issue, § 4061(a)(1) provided as follows:

> (a) *Automobiles.*—There is hereby imposed upon the following articles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof) sold by the manufacturer, producer, or importer a tax equivalent to the specified percent of the price for which so sold:
>
> (1) Articles taxable at 10 percent, except that on and after October 1, 1972, the rate shall be 5 percent—
>
> Automobile truck chassis.
> Automobile truck bodies.
> Automobile bus chassis.
> Automobile bus bodies.
> Truck and bus trailer and semitrailer chassis.
> Truck and bus trailer and semitrailer bodies.
> Tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.
>
> A sale of an automobile truck, bus, truck or bus trailer or semitrailer shall, for the purposes of this paragraph, be considered to be a sale of a chassis and of a body enumerated in this paragraph.

Defendant contends that the air-conditioning systems in question are taxable under § 4061(a) because they are "parts or accessories" and because they were "sold on * * * Automobile bus bodies." There is no dispute that the air-conditioning systems here in issue were sold on plaintiff's buses. As for their qualification as "parts or accessories," we note that § 48.4061(b)-2(a) (1963), Treasury Regulations on Manufacturers and Retailers Excise Taxes, reads as follows:

> (a) *In general.* The term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or other automobile chassis or body, or taxable tractor, (2) any

> article designed to be attached to or used in connection with such chassis, body, or tractor to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use. * * *

Because (1) air conditioning was sold on plaintiff's buses as a system, (2) the component parts were built in, custom fitted, or specifically designed primarily for use in bus air-conditioning systems, and (3) these systems were designed to provide a comfortable atmosphere for bus passengers, they clearly constitute parts or accessories. Moreover, the regulations expressly include "Automobile air conditioners" as the first example given of taxable parts or accessories in § 48.4061(b)-2(d). See, also, Rev. Rul. 56-544, 1956-2 Cum. Bull. 797 (where automobile air conditioners sold with a taxable motor vehicle were held, in the first published position by the Internal Revenue Service, to be subject to tax under § 4061(a)); for later rulings expressly holding bus air conditioners to be subject to the parts and accessories tax, see Rev. Rul 63-23, 1963-1 Cum. Bull. 206, 207, and Rev. Rul. 69-578, 1969-2 Cum. Bull 199.

As above shown, it appears that plaintiff's bus air-conditioning systems fall within the plain language of § 4061(a), imposing a tax on parts or accessories sold with buses. Plaintiff nevertheless maintains that its air-conditioning systems are excluded from taxation thereunder, relying upon the decisions by the Court of Claims in *Thermo King Corp.* v. *United States*, 173 Ct. Cl. 860, 354 F. 2d 242 (1965), and *U.S. Thermo Control Co.* v. *United States*, 178 Ct. Cl. 561, 372 F. 2d 964, *cert. denied*, 389 U.S. 839 (1967), and Rev. Rul. 68-136, 1968-1 Cum. Bull. 453. These two decisions involved the taxability of truck refrigeration units under § 4061(b), the automobile parts and accessories tax. This court held that the refrigeration units were taxable under the tax on commercial refrigerators of § 3405, Int. Rev. Code of 1939, as amended in 1941, and after the repeal in 1942 of the commercial refrigerator tax provisions of § 3405, the refrigeration units were not subject to any excise tax, there

being no legislative expression to the contrary. In Rev. Rul. 68–136, 1968–1 Cum. Bull. 453, 454, the Internal Revenue Service held, in view of the two decisions, that sales of "refrigeration units designed to be installed in taxable truck or trailer bodies" are not subject to the automotive excise tax on parts or accessories and it further stated:

> The conclusions expressed in this Revenue Ruling are applicable only to refrigeration units designed to be installed in taxable trucks or trailer bodies. These conclusions are not to be extended so as to exclude from manufacturers excise tax any other article (1) the sale of which is within the scope of section 4061(b)(1) of the Code, or (2) properly includible in the tax base for sales of chassis and bodies subject to the tax imposed by section 4061(a).

Plaintiff argues that the air-conditioning systems installed on its buses are equivalent to the truck refrigeration units involved in the *Thermo* decisions. Therefore, plaintiff argues, its systems come within the two aforementioned, prior *Thermo* decisions and are not taxable under § 4061. Plaintiff and defendant have submitted drawing sections, portions of plaintiff's sales literature, affidavits, portions of depositions, and references to definitions and descriptions in standard engineering manuals. We have carefully examined for submissions by the parties. We conclude and find from them that there is no dispute as to any material fact for the resolution of the issue presented in discussion of § 3405(a). Although plaintiff's systems employ refrigeration components, that fact does not make them refrigeration systems. We find that the systems viewed as a whole are properly characterized as air-conditioning systems and not as refrigeration systems, because the systems here in issue do not just cool; rather, they cool, filter, and dehumidify fresh and recirculating air, which is distributed through floor, ceiling, or wall ducts. We also find that plaintiff's bus air-conditioning systems do contain devices which are designed to control the humidity of the air as well as its temperature, cleanliness, and distribution to meet the requirements of the bus, that those systems do considerably more than refrigerate and cool the air. We

therefore, find they are not "refrigerating units" or "refrigerators" (as those terms were used legislatively in 1941). Therefore, they would not have been taxable under subsection (a) of the 1941 excise tax provisions. They are taxable under § 4061, Int. Rev. Code of 1954.

There was a parallel case submitted on cross motions for summary judgment argued along with the instant case, *Motor Coach Industries, Inc.* v. *United States*, *ante* at 188. We have decided that case in favor of defendant by an opinion of the same date as this opinion. We refer to the opinion in that case and incorporate it herein for a fuller explanation of our reasons for so holding.

CONCLUSION

For the above reasons we conclude as a matter of law that defendant's motion for summary judgment is granted, plaintiff's motion for summary judgment is denied, and the petition is dismissed.

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537 F. 2d 393

UNIVERSAL FIBERGLASS CORPORATION v. THE UNITED STATES

[No. 85–70. Decided June 16, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; disputes; default termination; failure to make progress.—In January 1965 plaintiff entered into a contract with GSA for production of 12,714 three-wheel mail delivery trucks (mailsters), a pilot model to be available for inspection by June 27, 1965, and with production scheduled at the rate of 75 units per day by July 27, 1965. Although a pilot model was accepted, plaintiff was unable to deliver any vehicles by the latter date. Three time extensions were granted, the last one setting first delivery of 30 vehicles per day to expire April 21, 1966. In August 1966, after negotiations concerning price adjustment, etc., Amendment 4 was executed changing the specifications to include certain safety features in compliance with new Federal Safety Standards. While the amendment required plaintiff to furnish the contracting officer with a revised delivery

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schedule no later than October 1, 1966, it was not forthcoming. On October 12, 1966 defendant again requested immediate submissions of a revised delivery schedule. Suppliers were refusing plaintiff's orders because of its poor financial condition. As of November 30, 1966, with the exception of a pilot model, plaintiff had not manufactured any vehicles under the revised specifications, and on that date defendant issued a preliminary notice of default giving plaintiff 10 days to cure all of its defaults. Plaintiff waived its rights to the full 10-day period, and on December 2, 1966 the contract was default terminated for *inter alia*, failure to make progress. The contract appeals board upheld the default termination, determining that the contracting officer was justified in declaring plaintiff in default based on the entire record, including prior performance, performance and production capacity, and plaintiff's financial condition at the time of termination. Plaintiff requests review under Wunderlich Act standards. Defendant has filed three counterclaims which were not raised administratively. It is *held* for the reasons set forth that the contract was properly terminated for failure to make progress. It is also *held* that defendant, although it did not raise the counterclaims administratively did not intend to abandon them but rather was postponing them pending resolution of the merits of the termination action. Plaintiff is not entitled to recover, its motion for summary judgment is denied and defendant's cross-motion is granted. Further proceedings are stayed for 6 months and the case is remanded to the appropriate administrative authority to determine the merits of defendant's counterclaims. Dismissal of the petition will await final action thereon.

Contracts; termination; default termination; failure to make progress.

[1] Although plaintiff, who had not produced the items pursuant to the new specifications imposed by contract amendment which required plaintiff to furnish a revised delivery schedule by October 1, did not comply with the request, a subsequent request on October 12 by the contracting officer to submit such a schedule constituted a waiver of plaintiff's failure to deliver by that date. However, where conditions resulting from plaintiff's non-performance and delay prior to October 12 continued uncorrected thereafter, the mere fact that the contracting officer on October 12 was aware of plaintiff's problems does not bar a later default termination for failure to make progress if other reasons present before October 12 in fact justified termination and continued after the waiver.

United States ⟸ 73(3, 22)

Contracts; termination; default termination; failure to make progress; financial condition.

[2] The reference in the contract default clause to failure to make progress means progress *per se*, and a contractor's failure to honor

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warranties and submission of improper progress payment vouchers are collateral matters and should not be construed as failure to make progress. However, inadequate financing is not collateral when it pervades the entire contract and results in failure to make progress, such as occasioned by the refusal of parts suppliers to fulfill orders because of plaintiff's poor financial condition.

United States ⇐ 73(1)

Contracts; termination; default termination; failure to make progress; waiver of 10-day cure notice.

[3] Where after futile requests to plaintiff to furnish a revised delivery schedule and plaintiff's failure to produce any of the items incorporating the new safety standards imposed by a contract amendment to which plaintiff agreed, defendant issued a preliminary notice of default giving plaintiff 10 days to cure its deficiencies, plaintiff's waiver of the notice period indicates that it remained unable to make progress within the period. Failure to make progress is different from failure to deliver. Under the subject default clause, the "cure notice" provision for "failure to make progress" termination is intended to supply the absence of a specific time marker to advise when the time for default has arrived.

United States ⇐ 72(7)

Counterclaims; pendency of claims in other courts; rights of Government as defendant in Court of Claims.

[4] The United States does not lose its right to assert a counterclaim in a suit brought by the contractor in the Court of Claims under the Tucker Act because the United States filed suit in a district court under the False Claims Act against the contractor based on the same cause of action.

United States ⇐ 75(3)

Contracts; counterclaims; failure to exhaust administrative remedies.

[5] The United States does not lose its right to counterclaim in a suit brought by the contractor in the Court of Claims under the Tucker Act alleging wrongful default termination because of failure to raise the counterclaim administratively, where the counterclaim is based on the same cause of action pending in a district court brought by the United States under the False Claims Act, where the suit was dismissed without prejudice to the Government's right to raise the claim in this court, and where there has been no trial or fact finding on the counter-claim issue nor resolution on the merits of the termination action. Under such circumstances, and since the merits of the counterclaim have not been considered administratively, the court will remand the counterclaim for administrative processing.

United States ⇐ 75(3)

Administrative Law and Procedure 229

Opinion of the Court

Contracts; counterclaims; failure to exhaust administrative remedies.

[6] In Wunderlich Act review of a decision of a contract appeals board upholding a default termination, the Court of Claims will not grant the Government summary judgment on its counterclaims for certain specific monetary recovery where the Government did not pursue its administrative remedies thereon pending final outcome on the merits of the preliminary or threshold question of default termination. The counterclaims, instead, will be remanded for administrative processing.

Courts ⟸ 470

Karen E. Hakel, for plaintiff. *Rocco J. Russo*, attorney of record.

Michael J. Rubin, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before SKELTON, NICHOLS, and KASHIWA, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

This is a contract action wherein this court, by cross motions for summary judgment, has been asked to review a decision of the General Services Administration (GSA) Board of Contract Appeals (Board), 71-1 BCA ¶ 8901, in accordance with the standards of the Wunderlich Act, 41 U.S.C. Secs. 321-22 (1970). Defendant has counterclaimed for $2,363,508.04, plus interest. Trial Judge Bernhardt has submitted a recommended decision and conclusion of law in accordance with Rule 166(c). We agree with the result as to the main question, the termination for default, but arrive at it for different reasons. We differ as to his disposition of the counterclaims.

I.

On August 31, 1964, the Government solicited bids for the purchase of 12,714 mailsters (small 3-wheel mail delivery trucks). The original delivery schedule, as amended by Special Notice No. 1 to Prospective Bidders, called for the contractor to have a pilot model available for inspection not later than June 27, 1965, and to achieve a production

rate of 75 units per day by July 27, 1965. Universal Fiberglass Corporation (UFC), the plaintiff, was the lowest bidder; however, representatives of the GSA were reluctant to award it the contract because of concern over its ability to perform. On the basis of the Small Business Administration's certification of competency, the GSA awarded the contract to UFC on January 27, 1965. After the contract was awarded to UFC, the Government repeatedly warned the contractor that failure to meet the delivery schedule would be grounds for termination of the contract.

On April 14, 1965, the Government accepted the pilot model, but plaintiff was unable to deliver any vehicles by July 27, 1965. In fact, plaintiff did not have the parts nor a delivery schedule of parts from suppliers to enable it to produce 75 mailsters per day and would not have been able so to produce until December 1965. The Government, in a memorandum dated October 29, 1965, formalized an Amendment No. 2, to the contract on November 29, 1965, agreeing to a time extension excusing 90 days of delay from July 27, 1965. A "final revised delivery" schedule was accepted as proposed by the contractor which called for a gradual increase in the rate of production and established "benchmarks" of delivery achievement:

December 24, 1965	30 vehicles per day
January 7, 1966	52 vehicles per day
January 21, 1966	75 vehicles per day

By December 24, 1965, the first "benchmark" had not been reached. Although 366 acceptable vehicles should have been delivered by December 28, 1965, only 127 had in fact been accepted. On January 28, 1966, the parties agreed to another time extension as follows:

March 16, 1966	30 vehicles per day
March 28, 1966	52 vehicles per day
April 11, 1966	75 vehicles per day

Plaintiff was unable to meet the revised schedule and the Government then agreed to yet another adjustment:

April 21, 1966	30 vehicles per day
May 3, 1966	52 vehicles per day
May 17, 1966	75 vehicles per day

On April 8, 1966, a fire partially destroyed portions of plaintiff's plant. The April 21, 1966, "benchmark" was not fully met; however, the contractor was resuming production and supplied the Government with approximately twenty vehicles per day by April 28, 1966. As of that date, plaintiff had 208 vehicles in various stages of production.

During 1966, many of the vehicles delivered were deficient. The repair facilities were inadequate, despite the Government's repeated demands upon plaintiff to provide repairs in accordance with the contract.

In May 1966, negotiations ensued between all parties to determine the precise nature of necessary specifications changes, the price adjustment and possible extensions of the delivery schedule. On August 9, 1966, Amendment No. 4 was executed which changed the specifications to include certain safety features in compliance with the new Federal Safety Standards. All vehicles produced after September 27, 1966, were to have these new features, which included a four wheel instead of a three wheel design, requiring the scrapping of many parts. The Amendment required the contractor to furnish the contracting officer with a revised delivery schedule no later than October 1, 1966.

A pilot model incorporating the Amendment No. 4 changes was conditionally approved by the Government on September 30, 1966. The Government was doubtful about plaintiff's ability to perform the contract, however, because of an audit performed by a Government accountant which concluded that plaintiff was insolvent.

Plaintiff was unable to furnish a revised delivery schedule by October 1, 1966. It had informed the Government of its difficulties in obtaining the component parts required by Amendment 4. On October 1, the Government asked plaintiff to furnish its proposed revised delivery schedule and advised plaintiff that the responsibility for securing the necessary parts was the plaintiff's. On October 12, 1966, the Government again requested immediate submission of a revised delivery schedule.

On November 1, 1966, the Commissioner of the Federal Supply Service wrote the plaintiff, citing the results of the

September audit and asked the plaintiff to furnish a detailed arrangement for completion of the contract. Plaintiff responded by letter of November 14, 1966, alleging that the Government was responsible for its increased costs and that the contract might be impossible to perform.

Plaintiff was forced virtually to close down its production lines in the plant after September 27, 1966, and to lay off most of its labor force. As of September 27, 1966, plaintiff had a production force of about 220. Plaintiff's records indicate an expenditure of $82,140 for hourly and salaried employees during the 2 months preceding termination on December 2, 1966. Some of this activity consisted of ordered and expediting parts. Other activity consisted of processing 44 vehicles manufactured under the old specifications before September 27, 1966, for delivery to the Government. Towards the end of October plaintiff briefly restarted production line in an effort to complete 11 vehicles under the new specifications, but the lack of required parts prevented their completion. During October 1966, plaintiff continued on a reduced scale the manufacture of fiberglass bodies for the vehicle, but thereafter this too was discontinued. The plaintiff's records reflect that during the first half of November 1966, plaintiff had 24 hourly employees who worked a total of 1,134¾ manhours on various days, and in the last half of November it had 19 hourly employees who worked a total of 1,112¾ manhours on various days. No vehicles were ever produced by plaintiff under the new specifications imposed by Amendment No. 4, except a pilot model. Plaintiff had stopped production and would have had great difficulty in continuing the contract. Plaintiff had lost $1,400,000 on the contract by March 31, 1966, and would have sustained an even greater loss had the contract been completed. The Government understood that several parts suppliers were refusing plaintiff's orders because of its poor financial condition. Plaintiff was not ready, willing and able to perform the contract because of its inadequate financial condition.

As of November 30, 1966, plaintiff had not manufactured any vehicles incorporating the new safety standards. On that date, the Government issued a Preliminary Notice of De-

fault which gave plaintiff ten days to cure all of its defaults. Plaintiff, by letter dated December 1, 1966, waived its rights to the full ten day notice period. The contract was terminated for default on December 2, 1966, for the following reasons: (1) Failure to deliver, (2) Failure to make progress, (3) Failure to comply with provisions of the Progress Payments Clause, and (4) Failure to comply with the Warranty Clause.

Plaintiff appealed the termination to the GSA Board. The first appeal was on the limited issue of whether the right to terminate for failure to deliver had been waived. On July 7, 1969, the Board found that the Government, by its conduct, had waived the delivery schedule up to October 12, 1966. 69–2 BCA ¶ 7780.

Plaintiff thereupon moved the Board to set aside the default termination. The Board determined that a hearing was necessary on the factual question of "whether the Government waited a reasonable time for delivery of mailsters to be produced under the revised specifications." 70–2 BCA ¶ 8440. On March 6, 1970, plaintiff filed a petition in this court. By order of February 17, 1971, the court stayed its proceedings pending administrative resolution of the remaining issues.

The Board held hearings on April 6, 7, 8 and 12, 1971, and then on May 28, 1971, issued its decision upholding the default termination. 71–1 BCA ¶ 8901. The Board found that "based on the entire record, including prior performance * * *, performance and production capacity, financial condition of the [plaintiff] at the time of termination, and [plaintiff's] waiver of the ten day notice, * * * the Contracting Officer was justified in declaring [plaintiff] in default."

Our trial judge has concluded that the Board's affirmation of the contract termination was not supported by substantial evidence with respect to failure to deliver and to make progress but was supported by substantial evidence with respect to the non-compliance with progress payments provisions and the breach of warranty grounds. For the reasons discussed below, we think that plaintiff clearly was properly terminated for failure to make progress and therefore we need not and do not consider the propriety of the other listed

grounds for termination, which are not so clear, but do not affect the result.

II.

The Default Clause of this contract reads, in pertinent part as follows:

> 11. Default
> (a) The Government may, subject to the provisions of paragraph (c) below, by written notice of default to the Contractor, terminate the whole or any part of this contract in any one of the following circumstances:
> (i) if the Contractor fails to make delivery of the supplies or to perform the services within the time specified herein or any extension thereof; or
> (ii) if the Contractor fails to perform any of the other provisions of this contract, *or so fails to make progress as to endanger performance of this contract in accordance with its terms*, and in either of these two circumstances does not cure such failure within a period of 10 days (or such longer period as the Contracting Officer may authorize in writing) after receipt of notice from the Contracting Officer specifying such failure. (Emphasis supplied).

The Board's enumeration of reasons supporting a finding of "failure to make progress, a listed basis for default," included "lack of production, inadequate financial condition, failure to correct warranty defects, submittal of excessive and improper progress payment vouchers, general lack of production 'know-how', failure to state adequate delivery schedule, and waiver of the ten-day cure notice." These reasons are identical to those assigned by the Board to support failure to deliver as a companion ground of termination.

On October 12, 1966, the contracting officer asked the contractor to submit a revised delivery schedule. The Board concluded that this constituted a waiver of plaintiff's failure to deliver by that date. The contracting officer obviously contemplated that the plaintiff would deliver at some time; to deliver, the plaintiff would have to make progress. The waiver, although specifically only to delivery, impliedly waived plaintiff's failure to "progress [so] as to endanger performance of the contract." The contracting officer recognized that progress would be delayed somewhat, although he

did not expect that it would be abandoned. The October 12, 1966, letter was probably not intended by the contracting officer to be a waiver of default for non-delivery even though the Board found, and we agree, that it operated to that effect. Still less was it intended as a waiver of the failure to make progress, obviously. It was more in the nature of a warning that such failure was not unnoticed.

The trial judge found that failure to progress cannot be measured by plaintiff's actions prior to the October 12, 1966, waiver. However, if conditions resulting from these actions continued after the waiver date uncorrected, the mere fact that the contracting officer was on October 12, aware of plaintiff's problems does not bar a later termination. Plaintiff's actions, before October 12, indicate a pattern of nonperformance and delay which should not be ignored. Although not justifications for default in themselves, they provide a context for understanding and evaluating plaintiff's continued problems. Moreover, the contracting officer could still terminate plaintiff for failure to make progress after October 12, 1966, relying on the reasons cited above, if those reasons in fact justified termination and continued after the waiver.

The specific reasons cited by the Board should be examined to determine if they were uncured after October 12, 1966, and justified termination for failure to make progress. The trial judge said that the default clause contemplates failure of actual, physical production, not merely a collateral threat to production due to inadequate financing, failure to honor warranties, and submission of improper progress payment requests. The trial judge concluded that the Board's determination was legally incorrect because it defaulted plaintiff for collateral threats to production, which at most constitute independent grounds for termination. The trial judge stated (trial judge's opinion at 12):

> * * * [These collateral circumstances] must not be confused with production progress *per se*. The test of progress is production, and the criterion is existing delivery requirements. Progress means production, and does not mean curable threats to production such as insolvency.

We agree with the trial judge that plaintiff's failure to honor warranties and submission of improper progress payment vouchers are collateral matters and should not be construed as failure to make progress. The contracting officer relied on these two reasons as independent grounds for termination. However, inadequate financing is not collateral when it pervades the entire contract. Plaintiff's lack of financing was the reason it was unable to progress since its suppliers were unwilling to provide the necessary parts because of their concern about plaintiff's financial position.

Plaintiff's waiver of the 10 day cure notice was listed as a reason for the termination for failure to make progress. The trial judge states that this waiver was not related to plaintiff's failure to make progress. The Armed Services Board of Contract Appeals considered a similar question in *C. C. Galbraith & Son, Inc.*, 67–2 BCA ¶ 6488. The contracting officer set a new delivery date after waiving the original delivery date and directed the contractor to show that it was taking corrective action to remedy its deficiencies thereby demonstrating its willingness and ability to perform within the extended delivery period. Failure to show that corrective action was being taken was regarded as failure to make progress. UFC's waiver of the 10 day cure notice indicates that it remained unable to make progress within the 10 day period.

Failure to make progress is obviously something different from failure to deliver, or else the default clause would not provide separately for both. The trial judge, in our view, failed to allow for this difference and in effect holds that the only contractor who fails to make progress is one who fails to deliver. This cannot be. It is, as he says "almost a truism that a contractor who fails to make progress will also fail to deliver". To be sure, but does this mean that a contractor whose delivery date has not arrived must necessarily not have failed to make progress? It would seem the trial judge thought so. Thus he thinks condoning non-delivery is also condoning not making progress. We fear he has indulged in a staggering non-sequitur. The distance between failure to make progress and failure to deliver may be greater in the case of, *e.g.*, a contract to build a single aircraft carrier, but

it does not close to the infinitesimal merely because the contract is for multiple units.

As we read the default clause here to be construed, the "cure notice" provision for "failure to make progress" terminations is obviously intended to supply the absence of a specific time marker to advise when the minute for default has been reached, such as exists when a contract delivery date has passed without delivery. Thus to have prescribed a new delivery schedule also would have been superderogatory. The "cure notice" served its purpose. The contractor had already been asked to submit a new delivery schedule and had not done so. Nor had the contracting officer learned, from the contractor or any other source, any information to lead him to believe that deliveries would or could ever be resumed. In such circumstances, a unilateral delivery schedule prescribed by him would have been an exercise in futility, except for forensic purposes, should we be so foolish as to give the absence of such a schedule any legal significance or weight. Plaintiff was making no progress at all, had never manufactured a vehicle under the new specifications it had agreed to, did not have the necessary parts and could not obtain them and had allowed its labor force to wither away. If this situation is not what this failure to make progress clause is about and is not the exact case for which it was written, we are at a loss to understand why it was put in the contract at all. The contract having been properly terminated for failure to make progress, we need not grapple with the troublesome and difficult arguments the parties have offered us, concerning the other grounds for default alleged by the contracting officer and the Board. In any case, they appear to be makeweights as compared to the overwhelming impact of the failure to make progress.

III.

Defendant, in its answer, presented three counterclaims totalling $2,363,508.04, plus interest. The first counterclaim alleges that there is an outstanding and unrecouped balance of $2,022,279.23, representing the excess of progress payment funds received by plaintiff from defendant over the amount

properly credited to plaintiff for delivered items and inventory sold. The second counterclaim alleges that plaintiff owes defendant $300,716.26, the amount by which UFC "was overpaid as a result of the excise tax exemption which was effective after the tax inclusive date established by the contract." The third counterclaim, for $40,512.55, was based on plaintiff's alleged failure to meet its obligations under the Warranty Clause of the contract and the resultant cost to defendant to make repairs in delivered vehicles.

The counterclaims were not raised administratively nor were they briefed in defendant's motion for summary judgment. The trial judge dismissed the counterclaims, apparently because he felt that defendant had abandoned the claims. We do not think the defendant intended to abandon the counterclaims, but rather was postponing the claims pending the resolution of the merits of the termination action.

Defendant had filed suit in the United States District Court for the Northern District of Ohio, Civil Action No. C 71–303, pursuant to the False Claims Act, 31 U.S.C. Secs. 231–235 to recover amounts owed due to fraudulent progress payment vouchers, the subject matter of the first counterclaim. It is unfortunate that defendant did not file the False Claims suit in this court as a counterclaim so that we could adjudicate the matter with an understanding of the entire circumstances of this case. However, defendant is not required to file its False Claims action in this court. It is interesting that 28 U.S.C. Sec. 1500 provides that the Court of Claims does not have jurisdiction of any claim which the *plaintiff* has pending in another court. In *Frantz Equipment Co.* v. *United States*, 120 Ct. Cl. 312 (1951), the court held that where the plaintiff had filed a petition in this court based on the same subject matter as a counterclaim in the United States District Court for the Eastern District of Pennsylvania, suit was barred by 28 U.S.C. Sec. 1500. The provision was intended to bar duplicate suits against the Government and therefore does not apply when the Government, a defendant in this court, files suit in another Federal court. We held in *Frantz Equipment Co.* v. *United States*, 122 Ct. Cl. 622, 631, 105 F. Supp. 490, 496 (1952), that the defendant does not lose its

right to assert a counterclaim in this court because it filed suit in a District Court based on the same cause of action.

We do not think that the trial judge's dismissal of the first counterclaim was appropriate, since the Ohio suit was still pending at that time. A stipulation of compromise was filed in the District Court on May 4, 1976, dismissing the claims brought pursuant to the False Claims Act with prejudice. Defendant's claim that plaintiff received excess progress payment funds was dismissed without prejudice to the Government's right to raise the claim in this court or elsewhere without regard to the statute of limitations. We now have to determine whether plaintiff did in fact receive an excess of progress payment funds over the amount properly credited to plaintiff for delivered items and inventory sold. Since the compromise agreement was specifically without prejudice to the suit here, we should determine whether defendant is entitled to any relief. However, there has not been any hearing or fact finding of any kind on this issue in this court. Moreover, in view of the fact that neither the contracting officer nor the GSA Board of Contract Appeals has considered the merits of defendant's counterclaims we are remanding the counterclaim to the GSA, such officers or agencies as may be appropriate for administrative processing.

In defendant's request for review of the trial judge's decision, it asserts that the second and third counterclaims are redressable administratively and should be remanded to an administrative tribunal. Defendant argued that it did not pursue its administrative remedies on them pending a final outcome on the merits of the default termination. There has not been any determination as to the merits of the counterclaims. *See*, *Nager Elec. Co.* v. *United States*, 194 Ct. Cl. 835, 442 F. 2d 936 (1971). Defendant did not pursue its claims below because it was defending the propriety of the default termination, a preliminary or threshold question. We are not granting summary judgment on the second and third counterclaims but instead remand along with defendant's first counterclaim to the GSA, for administrative processing. *Martin Lane Co.* v. *United States*, 193 Ct. Cl. 203, 432 F. 2d 1013 (1970), does not apply.

Syllabus

In conclusion, we hold that plaintiff's contract was properly terminated for failure to make progress. Accordingly, plaintiff is not entitled to recover on its claims, plaintiff's motion for summary judgment is denied and defendant's motion for summary judgment is granted. The dismissal of plaintiff's petition will await final action on defendant's counterclaims. Further proceedings in this court are stayed for six months and we remand the case to the General Services Administration, such officers or agencies as may be appropriate, pursuant to Pub. L. 92–415, and the court's Rule 149(b), to determine the merits of all three of defendant's counterclaims. Defendant's counsel is instructed to advise the court of the status of the proceedings at 90-day intervals, pursuant to Rule 149(f).

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537 F. 2d 400

UNIVERSAL FIBERGLASS CORPORATION, ET AL. v. THE UNITED STATES

[No. 285–68. Decided June 16, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; subcontractor's claim; default termination of prime contract; convenience of Government termination.—This case arises from the default termination of a GSA prime contract awarded in January 1965 to Universal Fiberglass Corp. (UFC) for production of three-wheel mail delivery trucks. In May and August 1965 UFC issued purchase orders to Dana Corporation for rear axles and differential frameworks. On August 9, 1966 by Amendment 4, the specifications of the prime contract were amended to include certain features in compliance with new Federal Safety Standards, including conversion of the vehicles from three wheels to four, thereby obsoleting the rear axles and frameworks subcontracts. On the same date UFC terminated Dana's subcontracts. On December 4, 1966 the prime contract was default terminated. Dana submitted cost claims which the contracting officer denied on April 29, 1968 for lack of privity between Dana and the Government. Dana's appeal to the board of contract appeals was dismissed on Dana's motion without prejudice to reinstatement should the Court of Claims determine existence of any matter requiring administrative action. Plaintiff contends here that Amendment 4 constituted a constructive partial termination in the guise of a change order; that Dana had vested

Syllabus

rights to termination costs at the moment of subcontract termination; that the prime contract default termination did not affect Dana's vested rights in its claim for the convenience termination of the subcontracts; and that Dana's convenience termination claim is not subject to offset of debts by UFC to defendant. It is *held* that Dana is not entitled to recover convenience termination costs because a subcontractor has no contractual rights against the Government and must seek settlement of its termination claims against the prime contractor with whom it contracted; here the Government never assumed the obligation to pay Dana's claims. As to the Government's counterclaims, consonant with the opinion in *Universal Fiberglass Corp.* v. *United States*, decided today, ante at 206, the proceedings in this court are stayed for 6 months and the counterclaims are remanded to the administrative authority to determine the merits thereof. Plaintiff is not entitled to recover, its motion for summary judgment is denied, defendant's cross-motion is granted. Dismissal of the petition will await final action on the counterclaims.

Contracts; termination; convenience of Government termination; partial termination; subcontractor's claim.

[1] Amendment to the prime contract causing cancellation of the subcontracts amounts to a constructive partial termination of the prime contract and a total termination of the subcontracts, all for the Government's convenience.

United States ⇐ 72(1)

Contracts; termination; convenience of Government termination; settlement of subcontractor claim; Government discretion.

[2] A subcontractor whose subcontract was rendered obsolete by an amendment to the prime contract and was cancelled, does not have a vested right in a subcontract termination claim unless and until the Government pursuant to Federal Procurement Regulations § 1-8.701(b)(4), exercises its discretionary authority and assumes the obligation to pay such claim.

United States ⇐ 74½

Contracts; subcontractor's claim; privity of contract lacking.

[3] The Contract Settlement Act and its attendant regulations subserve the basic principle in Government contract law that there is no privity of contract between subcontractors and the Government, and the prime contractor is responsible to the subcontractors who must look to the prime as their avenue of relief.

United States ⇐ 74½

Robert D. Witte, attorney of record for plaintiff. *Alan M. Lestz*, and *Witte & Witte*, of counsel.

Michael J. Rubin, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Opinion of Trial Judge

Before SKELTON, NICHOLS, and KASHIWA, *Judges.*

PER CURIAM: This case comes before the court on plaintiff's request, filed August 8, 1975, and defendant's request, filed August 15, 1975, for review by the court of the recommended decision of Trial Judge C. Murray Bernhardt, filed April 8, 1975, pursuant to Rule 166(c), and on plaintiff's motion and defendant's cross motion for summary judgment. The case has been submitted to the court on the briefs and oral argument. Upon consideration thereof, since the court agrees with the main part of the trial judge's recommended decision, as hereinafter set forth, it hereby affirms and adopts the same as the basis for its judgment in this case. However, we do not agree with the trial judge's recommended disposition of the counterclaims and therefore we do not adopt that portion of his recommended decision. As we held in the companion case of *Universal Fiberglass Corporation* v. *United States*, Ct. Cl. No. 85–70, *ante* at 206, the proceedings in this court are stayed for six months and we remand the counterclaims to the General Services Administration, such officers or agencies as may be appropriate, pursuant to Pub. L. 92–415, and the court's Rule 149(b), to determine the merits of defendant's counterclaims.

It is therefore concluded that plaintiff is not entitled to recover and plaintiff's motion for summary judgment is denied; defendant's cross motion for summary judgment is granted; defendant's counterclaims are remanded to the General Services Administration, such officers or agencies as may be appropriate. The dismissal of plaintiff's petition will await final action on defendant's counterclaims.

The opinion of the trial judge, as modified, follows:

OPINION OF TRIAL JUDGE

BERNHARDT, *Trial Judge:* By virtue of a court order of consolidation of March 19, 1973, this case is companion to *Universal Fiberglass Corp.* v. *United States*, Ct. Cl. No. 85–70, in which the court sustains, on a Wunderlich Act review proceeding, 41 U.S.C. §§ 321–22, a decision of the General Services Administration Board of Contract Appeals confirming default termination of a GSA contract for small

vehicles ("mailsters") designed for Post Office use. The gravamina of the two cases, however, proved, too dissimiliar to commend a combined opinion embracing both petitions without producing confusion; the same pod, but different peas. The instant claim, while deriving from a subcontract under the terminated prime contract, involves a termination for convenience contention that the subcontractor, Dana Corporation, as use plaintiff, says is not stilled by the default termination of the parent contract.

To place the present claim in factual perspective, a contract was awarded Universal Fiberglass Corporation (UFC) in January 1965 for 12,714 mailsters. In May and August 1965 UFC issued purchase orders to Dana for rear axles and differential frameworks. The purchase orders authorized UFC to terminate them at the buyer's option, limited UFC's resultant liability in the event of termination by excluding anticipated profit, and incorporated by reference section 8–706 of the Armed Services Procurement Regulations relating to convenience termination, although no such counterpart clause of the Federal Procurement Regulations appeared in the prime contract. On August 9, 1966, Amendment No. 4 was issued to the prime contract changing the specifications to include certain safety features in compliance with new Federal Safety Standards applicable to all vehicles produced after September 27, 1966. The changes included conversion of the vehicles from 3 wheels to 4, thereby obsoleting, *inter alia*, the rear axles and differential frameworks being supplied by Dana under its purchase orders.

Paragraph 5 of the amendment to the prime contract provided as follows:

> The ceiling of 1156 dollars total price per vehicle in paragraph 4 above does not include costs relative to inventory made obsolete by this amendment *nor costs relative to subcontract cancellations necessitated by this amendment.* It is understood and agreed that the contracting officer shall have the right to prescribe the manner of disposition of inventory made obsolete or excess as a result of this amendment. It is further understood and agreed that all settlements with subcontractors necessitated as a result of this amendment shall be coordinated in advance with the Contracting Officer. Failure to reach

> agreement as to costs covered in this paragraph 5 shall be treated as a dispute under the "Disputes" article of this contract. [Emphasis supplied.]

Under the amendment UFC was to submit to the contracting officer by October 1, 1966, data supporting an equitable price adjustment for the changes, "exclusive of data with respect to inventory made obsolete by those changes and data with respect to subcontract cancellations necessitated by these changes."

On August 9, 1966, the date of the amendment, UFC terminated Dana's subcontracts for the then obsolete materials and requested it to submit a termination claim. Thereafter over a period of 12 months, commencing in October 1966, GSA was furnished by UFC in behalf of Dana, and by Dana individually, various data with respect to its termination costs, culminating in a claim submitted by Dana on October 25, 1967, in the amount of $142,332.12. The claim was denied by the contracting officer on April 29, 1968, on the grounds of lack of privity between Dana and the Government, lack of any agency relationship between UFC and the Government making the latter liable as a principal for the debts of its agent, and the "total failure of consideration" for any obligation of the Government to absorb obsolescence costs under the amendment. The contracting officer also stated that the Government had no interest in the obsoleted materials, which Dana was invited to dispose of as it saw fit.

Since the quoted paragraph 5 of the amendment provided that failure to reach agreement as to such cost claims would be treated as a dispute under the Disputes article, on May 10, 1968, Dana appealed to the Board, which on August 29, 1968, on Dana's motion, dismissed the appeal "without prejudice to reinstatement thereof should the Court [of Claims] in which suit is filed determine that any matter or matters exist which require administrative action * * *." This suit followed, filed by UFC as trustee for the use and benefit of Dana, and by Dana individually. UFC had authorized Dana to sue in UFC's name for Dana's benefit and at the latter's expense.

In the meantime on December 2, 1966, the prime contract with UFC had been terminated for default, an action sus-

tained by the Board and, on review, by the trial division of the court in its opinion of March 18, 1975.

On March 19, 1973, the court entered an order in the instant petition on the parties' cross-motions for summary judgment, which dismissed Dana from the case in its individual capacity as plaintiff because Dana had shown no express or implied contract between itself and the Government, nor had demonstrated that UFC was merely an agent of the Government in dealing with Dana. The order, however, did not dismiss the claim of Dana as use plaintiff, but directed that its claim be consolidated with the claim by UFC under the prime contract for determination. That is the present posture of the matter, with UFC's claim under the prime contract having been recommended for dismissal by the trial division opinion in Court of Claims Case No. 85–70, and the termination claim of Dana under its subcontract being the sole outstanding issue in Court of Claims Case No. 285–68. The present issues are purely legal, as to which the Board decision properly stated its jurisdiction to be only permissive under the Wunderlich Act.

As pruned by the court's order of March 19, 1973, Dana's residual surviving contentions are that the amendment to the prime contract causing cancellation of the subcontracts in suit constituted a constructive partial termination in the guise of a change order; that Dana's rights to termination costs vested at the moment of subcontract termination brought about by the amendment to the prime contract; that the subsequent default termination of the prime contract did not affect Dana's vested rights in its claim for the convenience termination of the subcontracts; that Dana's convenience termination claim is not subject to offset of debts by UFC to the Government; that UFC is merely a trustee or fiduciary for Dana's recovery of its convenience termination costs with no pecuniary interest in the recovery; and that under the applicable section 1–8.701(b)(4) of the Federal Procurement Regulations (FPR) the Government had the option to settle directly with Dana for its convenience termination claim independent of UFC as trustee. The defense is in general denial of these contentions.

At the outset it seems clear that the amendment to the prime contract, which so profoundly changed the basic specifications of the vehicle and occasioned the abrupt termination of Dana's subcontracts, amounted to a constructive partial termination of the prime contract and a total termination of Dana's subcontracts, all for the Government's convenience. That is the law in this court (*General Contracting and Constr. Co.* v. *United States*, 84 Ct. Cl. 570 (1937)), elsewhere in the Federal court system (*J. W. Bateson Co.* v. *United States*, 308 F. 2d 510 (5th Cir. 1962)), and in the administrative sphere (*Nolan Bros., Inc.*, 58–2 BCA ¶ 1910). Substance prevails over form. Even in form the amendment to the prime contract dictated, in the absence of a standard FPR termination for convenience clause in the contract, a settlement procedure for the disposition of subcontractor inventory necessitated by the amendment. The amendment can only be read as a *sub silentio* incorporation by reference of 41 C.F.R., Part 1–8 (Rev. January 1, 1967), the Federal Procurement Regulations relating to termination of contracts.

41 U.S.C. ch. 2 provides for the termination of war contracts. Section 107(d) authorizes the contracting agency to "settle directly termination claims of subcontractors to the extent that it deems such action necessary or desirable for the expeditious and equitable settlement of such claims." Further:

> * * * Any contracting agency undertaking to settle the termination claim of any subcontractor shall deliver to the subcontractor and the war contractor liable to him written notice stating its acceptance of responsibility for settling his claim and the conditions applicable thereto, which may include the release, or assignment to the contracting agency, of his claim against the war contractor liable to him; upon consent thereto by the subcontractor, the Government shall become liable for the settlement of his claims upon the conditions specified in the notice.

The liability of the defendant to the use plaintiff Dana depends in this case on the quoted section. While the GSA entertained Dana's subcontract termination claim it did not accept responsibility for settling it, but rather rejected the

claim largely on the grounds of lack of privity. Failure of the agency to assume responsibility for subcontract claims presented under this section caused the dismissal of petitions in *Somerset Machine & Tool Co.* v. *United States*, 144 Ct. Cl. 481, *cert. denied* 361 U.S. 825 (1959), and in *Kal Machine Works, Inc* v. *United States*, 107 Ct. Cl. 202, 68 F. Supp. 436 (1946). To similar effect see *Precision Metal & Machine Co.* v. *United States*, 107 Ct. Cl. 219, 68 F. Supp. 437 (1946), and *General Elevator Co* v. *United States*, 122 Ct. Cl 467 (1952). CCH, GOVERNMENT CONTRACTS REPORTER, ¶ 12,130, states: "A subcontractor has no contractual rights against the government and must seek settlement of his termination claims against the prime contractor * * * with whom he contracted upon termination of the subcontract by the prime contractor * * *."

Dana claims to have had a vested right in its subcontract termination claim at the moment the subcontract was terminated by UFC. On the contrary, Dana enjoyed no vested right in such claim unless and until the GSA assumed the obligation to pay it. Until that transpires Dana's claim is solely against its prime contractor UFC, whose obligation it is under the Contract Settlement Act to pay the claim and seek reimbursement from the contracting agency.

The Federal Procurement Regulations, 41 C.F.R., rev. January 1967, make this clear. FPR § 1–8.701 suggests the form of a termination for convenience clause applicable to fixed-price contracts. It imposes on the prime contractor of a contract terminated for convenience of the Government the obligation to terminate subcontracts (para. (b)(3)), assign its right, title and interest under the terminated subcontracts to the Government so that the latter may thereafter, in its discretion, settle or pay subcontractor termination claims directly (para. (b)(4)), settle subcontract termination claims subject to approval by the contracting officer (para. (b)(5)), etc. Except to the extent that the contracting agency elects to settle or pay subcontract termination claims directly, the claims arising from termination for convenience of a prime contract are to be paid to the prime contractor, and by him in turn paid to deserving subcontractors on their termination claims.

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Dana, on the theory that its subcontract termination claim rights had vested, contends further that such rights are not subject to being offset by claims of the Government against UFC. If indeed a vesting of rights had occurred, or the defendant had elected to assume the obligation directly, then the defendant's counterclaims against UFC could not be set off. However, that not being the case, all claims arising from the termination for convenience of a prime contract, including subcontract termination claims, can be processed only through a settlement between the prime contractor and the contracting officer or, failing agreement, then by the unilateral determination of the latter. In such case paras. (d) and (e) of FPR § 1–8.701 limit recovery to the total contract price "as reduced by the amount of payments otherwise made and as further reduced by the contract price of work not terminated." Therefore, any Government counterclaims against UFC which exceed the termination for convenience conversion which UFC unsuccessfully sought in its claim under the prime contract would extinguish the termination for convenience claim of the prime contract as well as all subcontract termination claims ancillary thereto.

The Contract Settlement Act and its attendant regulations subserve the basic principle in Government contract law that there is no privity of contract between subcontractors and the Government, and the prime contractor is responsible to the subcontractors, who must look to the prime as their avenue of relief. This principle is so deeply engraved in case authority as to require no citation.

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536 F. 2d 921

UNITED STATES STEEL CORPORATION v. THE UNITED STATES

[No. 405–74. Decided June 16, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; disputes; breach of contract allegation; quantum meruit claim; hard-core job training program.—In 1969 plaintiff and the Department of Labor entered into a fixed-price contract to be per-

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formed from January 5, 1970 to June 5, 1971, extended by contract modification to November 17, 1971. The contract contained a disputes clause but no changes or other equitable adjustment clause. In general, the contract called for the filling of 1872 entry level job slots at plaintiff's premises by training hard-core unemployed individuals, the Indiana State Employment Service (SES), Concentrated Employment Program (CEP) and plaintiff to furnish referrals for said training. Plaintiff was to be paid by the Department of Labor $13.94 for each day worked by a trainee, up to a maximum of 195 days in each of the 1872 job slots, the maximum payment under the contract being $2,717.68 per job slot. Plaintiff was allowed to replace a lost trainee in a given slot with a new recruit. The scheduled rate of hiring was 48 new trainees per week during each of the first 39 weeks of the contract. During the first 13 weeks there were six trainees short of the rate of 48 per week, and beginning April 1, 1970 plaintiff conducted its own special recruiting program to supplement the referrals and its own normal recruitments. Plaintiff seeks reimbursement for the costs of this special recruitment. On April 20, 1970 plaintiff hired six job trainers, in addition to the job trainers called for in the contract; plaintiff seeks reimbursement for the costs of these trainers. In September 1970, due to a labor dispute in another industry, plaintiff laid off employees; it could not place new trainees in those areas, and to avoid laying off the trainees at the end of their 12th week, plaintiff retained them to work in other departments. Plaintiff claims reimbursement for the costs of this special training program. The contracting officer denied the claims which plaintiff presented, and on appeal the Department of Labor Board of Contract Appeals found that the majority of the claims were for extracontractual services or for damages which, if valid, could only be attributable to a breach of contract. The Board acknowledged it had no jurisdiction to grant relief as to those claims because the contract did not contain provisions allowing an equitable adjustment in the contract price. However, the Board allowed recovery for job simulation, or vestibule training, in another department as not being duplicative and due under the terms of the contract. Plaintiff claims here that defendant breached the contract in failing to furnish its 48 trainees per week and it therefore suffered direct damages as well as additional damages because of its recruiting program. Plaintiff also contends that it is entitled to recover on a quantum meruit or quasi-contract basis an amount for the special vestibule training above that allowed by the Board, and for the expenses of the six additional head trainers. It is *held* that defendant did not breach the contract since there was no requirement that the Department of Labor furnish 48 trainees per week; it was only to pay for the training of the persons who participated in the program. At the time plaintiff alleges the contract was breached SES

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and CEP had provided plaintiff with 1,044 referrals at the rate of 80 per week, but these referrals resulted in only 47.5 new trainees per week selected by plaintiff. Plaintiff is not entitled to recover on its damages claim nor the cost of its recruiting program. It is also *held* that plaintiff is not entitled to recover on its quantum meruit claim for six extra head trainers and for the extra basic training of the trainees, reversing the decision of the Board awarding plaintiff recovery for vestibule training. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Contracts; delays; extension of time; effect of on breach of contract claim.

[1] Where plaintiff was delayed in its contract performance by an alleged Government breach of contract, a contract modification extending the time for performance and thereby enabling plaintiff to obtain additional trainee replacements and to substantially improve its average return per job slot, cured any alleged breach.

United States ⟸ 72(11)

Contracts; breach; obligation under contract; what constitutes.

[2] Where, under the subject fixed-price contract to be conducted over a 52-week period, the SES and CEP were required to provide hard-core unemployed referrals for training by plaintiff to fill 1872 job slots to be trained in groups of 48 per week for 12 weeks at plaintiff's premises, the contract cannot be reasonably interpreted to impose upon SES and CEP the obligation to furnish thousands of referrals in order to meet plaintiff's demand for 1872 trainees, since only those who passed plaintiff's own standards were actually hired as trainees and defendant had no way of determining in advance how many referrals made by SES and CEP in a given week would actually be hired as trainees. Accordingly, defendent did not breach its contract when SES and CEP referred less than 48 actual trainees per week to plaintiff.

United States ⟸ 73(9)

Contracts; damages; mitigation of damages; contractual obligation of Government.

[3] Where the court has determined that the subject contract imposed no obligation on defendant to furnish 48 trainees per week to plaintiff, which deficit necessitated plaintiff to find recruits as trainees for the hard-core training program on its own, the expenses incurred by plaintiff in its special recruitment program as an alleged mitigation of damages for defendant's alleged breach of contract are not recoverable. Since the record indicates that as a result of the program plaintiff collected more than it otherwise would have, it is unreasonable to assert that the cost thereof was incurred solely because of the alleged breach.

United States ⟸ 74(12)

Syllabus

Contracts; implied contracts; implied in law.

[4] This court does not have jurisdiction under the Tucker Act of claims based on a contract implied in law.

Courts ⟸ 449(1)

Contracts; implied contracts; implied in law.

[5] Where an express contract exists between the parties, there can be no contract implied in law.

Contracts ⟸ 4

Contracts; damages; measure of damages; quantum meruit; generally.

[6] Absent a Changes clause or other clause providing for an equitable adjustment in the subject fixed-price contract, no adjustment can be made for the contractor's extra-contractual performance expenses.

United States ⟸ 74(13)

Contracts; disputes; administrative decision; finality of on question of law.

[7] A decision of a contract appeals board on a question of contract interpretation involves a question of law and under the standards of the Wunderlich Act is not binding on this court. Since the subject fixed-price contract, containing neither a Changes clause nor other equitable adjustment clause, did not authorize the contractor to train recruits to work in more than one division or department, a decision of the Board awarding additional compensation for job simulation training in another department as being within the terms of the contract because the additional training benefited the trainees and the Government and represented services rendered to accomplish the purpose of the contract, was an erroneous interpretation not binding on the court.

United States ⟸ 70(1)

Contracts; disputes; administrative decision; finality of decision; scope of judicial review.

[8] Where plaintiff-contractor has not agreed to accept an award by the contract appeals board as full settlement of its claim for additional training of recruits to work in more than one division or department, by suing in this court for the balance of the claim, plaintiff has kept the dispute alive and defendant has the right to contest the rest of the same claim, *distinguishing S&E Contractors, Inc.* v. *United States*, 406 U.S. 1 (1972).

Courts ⟸ 365

James T. Carney, attorney of record for plaintiff.

Stephen G. Anderson with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Opinion of the Court

Before SKELTON, KASHIWA, and KUNZIG, *Judges*.

SKELTON, *Judge*, delivered the opinion of the court:

This is an appeal by United States Steel Corporation (USS), plaintiff, from a decision of the Department of Labor Board of Contract Appeals (the Board), in which USS claims damages for an alleged breach of contract by the Department of Labor (DOL), with which it had a contract, and also claims alleged mitigating damages, plus a recovery on an alleged implied contract. The United States, defendant, denies that a breach of the contract occurred, and contends that there are no compensable mitigating damages, that no recovery can be allowed on an implied contract theory, and that the Board did not have jurisdiction of the case. The case is before us on cross-motions for summary judgment. The defendant has summarized the basic facts in the case, which we use in part, with additions and changes, to explain the nature of the case.

On November 12, 1969, plaintiff, United States Steel Corporation and defendant, Department of Labor, entered into a JOBS MA–5 fixed price contract, No. 16–0–5005–000. The contract period was from January 5, 1970 to June 5, 1971. The contract contained a disputes clause but no changes clause.

In general, the contract called for the filling of 1,872 entry level job slots at USS by training hard-core unemployed individuals certified by the Indiana State Employment Service (SES) and the Concentrated Employment Program (CEP). The cost of the contract was based upon only the training needed to make hard-core unemployed persons employable—the training USS normally gave to new employees was not part of the contract.

Instead of being directly reimbursed for the costs of the training program as they were incurred, USS was to be paid $13.94 for each day worked by a JOBS trainee, up to a maximum of 195 days in each of the 1,872 job slots. The maximum amount payable under the contract, therefore, was $2,717.68 per job slot, or $5,087,497 overall.

Although the contract was designed to maximize the contractor's incentive to keep trainees on its payroll, it was

acknowledged that, for many reasons, not all trainees would work the full 195 days needed for USS to receive the maximum contract amount. The contractor was allowed, therefore, to replace a lost trainee in a given job slot with a new recruit. By so doing, USS could continue to receive payment for the days worked in that job slot until the combined number of days worked by the initial trainee and any replacement(s) equalled 195.

Because it took 195 work days (39 weeks) for USS to receive the maximum contract amount for each job slot, it was anticipated that all the job slots would be filled initially by the time there were only 39 weeks left in the contract period. This meant that an average of 48 new trainees was needed during each of the first 39 weeks of the contract.

During the first 10 weeks of the contract, SES and CEP provided USS with 510 trainees, 30 more than the rate of 48 per week. During the next three weeks—the last three weeks in March 1970—the trainees numbered only 108, 36 less than the rate of 48 per week. That made the cumulative number of trainees provided during the first 13 weeks of the contract 618, six trainees short of the rate of 48 per week (an average of 47.54 trainees per week). The following week—the first week of April—62 new trainees were accepted into the program.

Beginning April 1, 1970, USS conducted its own special recruiting program to supplement the recruits obtained through SES, CEP, and the contractor's normal recruiting operation. This special recruiting effort eventually included the distribution of handbills, the intermittent use of a mobile recruiting van, and the services of three USS recruiters. USS has claimed the cost of the special recruiting to be $70,753. It is undisputed that this effort was not part of the express contract between the parties.

On April 20, 1970, USS hired six job trainers who were given the title of Head Job Trainers. It is undisputed that these were in addition to the job trainers called for in the contract. The head job trainers were employed in that capacity for various lengths of time but no later than September 1, 1971. USS claims the cost of the head job trainers was $135,954.

On June 22, 1970, a meeting occurred at the contractor's plant in Gary, Indiana (Gary Works). Present were Eugene E. Harris for USS and Michael S. White of the Regional Manpower Administrator's Office, Department of Labor. The meeting occurred during one of Mr. White's regular visits to Gary Works to monitor the contract performance of USS. He was not the contracting officer. It is undisputed this meeting was the first time USS advised DOL of the head job trainers. It is also undisputed that USS gave Mr. White no indication that USS expected to be paid for the head job trainers except as they might increase the number of days invoiced under the contract for work by JOBS trainees. Nor was any indication given that USS felt DOL had breached the contract or that DOL was in any way responsible for the cost of the special recruiting effort.

During September 1970, USS began to lay off employees in departments affected by a labor dispute at General Motors. Because of its own labor agreement, USS could not place new trainees in those departments so long as more senior employees were laid off. Although trainees did not begin to work in a given department until the 13th week of employment at USS, they had been pre-assigned to departments during the first week of training and to a certain extent their training differed depending on the department to which they were assigned. Hence at the same time it began to lay off its regular employees in a given department, USS also had a number of trainees in various stages of preparedness to take jobs in those departments. To avoid laying off these trainees at the end of their twelfth week, *i.e.*, at the time they would normally begin to work in their assigned department, USS kept them in the training program, retraining them to work in different departments. USS claims the cost of this "special training program" was $277,069.

On November 13, 1970, a meeting occurred at Gary Works between Eugene E. Harris of USS and Paul Burse. It is undisputed that at no relevant time was Mr. Burse an employee of the Government. He was, however, employed by Henderson & Associates, which had a contract with the Government to audit the USS JOBS MA–5 contract. It is also undisputed

that Mr. Burse was advised as to the special training program at that meeting.

On November 17, 1970, at the request of DOL, a second meeting was held with USS representatives at Gary Works. Present were Richard Reece, J. H. Cawley, and Michael White for DOL and D. W. Braithwaite, P. C. Fissinger, V. C. Sutcliffe, and Mr. Harris for USS. This meeting occurred seven months after the hiring of the head job trainers and the commencement of the special recruiting effort and almost two months after the beginning of the special training program. It is undisputed that all three areas were discussed, that this was the first time DOL employees had been officially advised of the special training program, and that USS indicated that these efforts had been undertaken with the continuing expectation that their cost would be more than recouped by improving the ratio of days worked per trainee, thereby increasing USS's payments under the contract.

By a modification to the contract dated December 10, 1970, the contract period was extended from June 5, 1971, to November 12, 1971. Aside from a modification on March 9, 1970, not relevant here, this was the only modification executed under the contract.

On May 26, 1971, a third meeting occurred between USS and DOL representatives. Present were W. P. Jones and S. Ganz for USS and B. Lewis, contracting officer, and E. Harp for DOL. At that meeting USS made a request for the first time to be paid for the special recruiting program, the head job trainers, and the special training program. It is undisputed that as to the head job trainers and the special training program no agreement of any kind was reached. It is further undisputed that prior to this meeting no contract modification had been sought by USS. As to the special training program there is some dispute as to what exactly was said by DOL representatives, but it is undisputed that the contracting officer said that if USS had wanted a contract modification it should have sought one earlier. It is further undisputed that no final agreement was reached as to any of the demands made by USS and that DOL agreed to send a representative to Gary Works to gather more information.

On June 9, 1971, a fourth meeting occurred, this time between Messrs. Braithwaite, Abbott, Miller, and Harris for USS and Mr. White for DOL. At this meeting USS made an explicit demand for reimbursement of the costs incurred for head job trainers, special training, special recruiting, and other claims now pursued before this court.

By a final opinion dated December 4, 1972, the contracting officer denied the claims discussed at the meeting of June 9, 1971.

On August 15, 1974, the Department of Labor Board of Contract Appeals entered its decision as to the contractor's appeal of the contracting officer's final decision. The Board found that all of the contractor's claims, with one small exception, were extra-contractual. Hence the cost of head job trainers and the special recruiting effort were entirely disallowed. As to the special training program the Board found that most of the costs were attributable to training that duplicated training for which USS had already been paid under the contract, and denied recovery as to those costs. The Board also found, however, that the job simulation, or vestibule training, was not duplicative and that the $38,369.47 cost thereof was payable under the contract.

The Department of Labor Board of Contract Appeals found that the majority of plaintiff's claims were for extra-contractual services or for damages which, if valid, could only be attributable to a breach of contract by defendant. The Board acknowledged that it had no jurisdiction to grant relief as to those claims because the contract did not contain any provision allowing an equitable adjustment in the contract price.

Following the decision of the Board, USS filed suit in this court claiming that DOL had breached the contract by failing to furnish it 48 trainees per week and because of which it suffered direct damages in the sum of $50,083.95, and suffered additional damages in the sum of $70,753 representing a recruiting program it voluntarily instituted to obtain more recruits or trainees for the program, all in the total sum of $120,836.95.

In addition to the claims for the alleged breach of contract stated above, plaintiff contends that it is entitled to recover

on a quantum meruit or quasi contract basis for extra training expenses not provided for in the contract for which was known as vestibule training of the trainees in the sum of $227,069, and for the expense of six additional head trainers used in such extra or special training program in the sum of $135,954, all in the total sum of $363,023.

The defendant says that it did not breach the contract and plaintiff's breach of contract claims are without merit. Defendant says further that there is no basis for plaintiff's quantum meruit claims because they are based on activities and transactions of the plaintiff not provided for in the contract and for which defendant is not liable. We will now consider these claims of the parties.

I

The Breach of Contract Claim

The contract provided that the program would be conducted over a 52-week period for 1,872 persons who would be recruited and trained in groups of 48 per week for 12 weeks. The furnishing of the recruits was to be a joint effort of SES, CEP and USS. There was no requirement that DOL was to furnish 48 trainees per week. In fact, the contract provided:

> The objective of this proposed program is to hire and provide training for 1,872 individuals certified as hard-core unemployed by the State Employment Service (SES). *The individuals will be recruited using the resources of the U.S. Steel Corporation's recruiting process and the State Employment Service (SES).* [Emphasis supplied.]

This provision imposed at least some obligation on USS to recruit at least some of the trainees. In other words, the whole burden and obligation was not imposed on SES. It appears that DOL was not to do any of the recruiting, but was only to pay for the training of the persons who participated in the program. The facts show that an average of 48 trainees was needed during each of the first 39 weeks of the program because it required 195 days (39 weeks) for USS to receive the maximum amount of each of the 1,872 slots. During the

first 10 weeks, SES and CEP provided referrals that resulted in 510 trainees, 30 more than 48 per week. During the last three weeks in March 1970, the referrals accepted as trainees amounted to 108 or 36 less than the rate of 48 per week. This meant that referrals resulting in 618 trainees were provided during the first 13 weeks, which were six trainees short of the 48 per week, or an average of 47.54 trainees per week. During the following first week of April, 62 new trainees were accepted. USS said nothing about a breach of contract until after November 12, 1971, following the expiration of the extended contract when it claimed that defendant had breached the contract in March 1970, by failing to supply it with 48 trainees per week. However, it is significant that for almost two years (March 1970 to November 1971) USS continued in the performance of the contract and received its benefits in the form of payments, without in any way indicating it was claiming a breach of contract. Even if a breach occurred in March of 1970, which we do not think was the case, the shortage of trainees accepted by USS from the referrals furnished by SES and CEP was so minimal as to be insignificant. Furthermore, as pointed out above, USS had some obligation itself to provide some of the trainees—surely this could require it to supply at least the missing .46 of one trainee (48 less 47.54).

The contract was modified by an instrument dated December 10, 1970, executed March 1971, which extended the contract from June 5, 1971, to November 12, 1971. If there had been a breach of the contract by defendant, this extension of the contract cured it.

The modification was of significant benefit to USS, but the Government received no additional consideration. By the end of the 40th week of the initial contract period, 2,076 recruits had been accepted into the program. This was more than 200 recruits above the contract amount of 1,872. The initial job slots already had been filled and the balance of recruits necessarily were replacements. Had the contract not been extended, the Government would have nonetheless received all it bargained for—the filling of 1,872 job slots with otherwise unemployable trainees and up to 195 days of train-

ing for those trainees who lasted in the program. The replacement of lost trainees was at the option of the contractor. While some incidental benefit accrued to the Government in that additional unemployed people were receiving training, the hard fact is the contractor only replaced trainees if it was economically advantageous for USS to do so. The modification came at a time when it was no longer advantageous for USS to replace trainees for only the initial contract period. By extending the contract until November, DOL permitted USS to obtain 387 additional replacements and substantially improve its average return per job slot.

It follows that even if the Government breached the original contract in March 1970, the only effect of that breach was to delay plaintiff's performance, and inasmuch as the contract was thereafter modified by the parties to extend the time for performance and thereby grant plaintiff additional compensation, there was no breach of the contract as modified. *Snare & Triest Co.* v. *United States*, 75 Ct. Cl. 326 (1932), *cert. denied*, 289 U.S. 742 (1933).

Not every recruit obtained by DOL and referred to USS was hired as a trainee. In fact, out of 322 referrals made by CEP prior to March 13, 1970, USS chose to hire only 44. Prior to March 28, 1970, SES made 720 referrals to USS. Consequently, at the time plaintiff alleges the contract was breached (March 31, 1970) DOL had provided USS with 1,044 referrals at the rate of 80 per week. These referrals resulted in only 47.5 new trainees per week selected by USS.

In light of the above, it is clear that, if DOL's obligation is stated as 48 referrals per week, no breach had occurred by the end of March 1970. In fact, DOL never breached an obligation to provide 1,872 referrals. The record shows that SES and CEP provided USS with a total of 2,586 referrals, far more than the 1,872 required by the contract. (1,651 referrals from SES and 935 from CEP).

Understandably, plaintiff argues that the "48 per week" requirement means 48 trainees per week. This interpretation is not reasonable because it defines DOL's obligation in terms over which it had no control. DOL did not provide *trainees* to USS, it provided referrals which were then screened by

USS. Only those who passed plaintiff's own standards were actually hired as trainees. As noted above, of the first 322 referrals made by CEP, only 44 were actually hired as trainees. At that rate, DOL would have had to obtain over 13,000 referrals to meet USS's demand for 1,872 trainees. There is nothing in the contract that could be construed to impose a requirement of that magnitude on DOL. In fact, the Labor Force Summary for 1970 shows that there were only 8,800 unemployed people in the Gary, Indiana area at the time the contract began in January 1970.

DOL had no way of determining in advance how many of the referrals made in a given week would actually be hired as trainees. Plaintiff's argument necessarily implies that the contract would be breached by DOL every time USS rejected an unusually large number of trainees for medical or other reasons. It cannot be inferred that the parties intended such a result when they drafted the agreement. It would therefore be unreasonable to construe the contract language to impose such a requirement.

USS embarked on a recruiting program on its own on April 1, 1970, in order to obtain more trainees for the program. It now says this action was taken because the defendant breached the contract in March 1970, by failing to furnish 48 trainees per week. It contends that the defendant should be required to pay the expenses of this program in the sum of $70,753 as a part of the damages for breach of contract. It should be pointed out that during the negotiation stage before the contract was executed, USS asked DOL to agree to pay the costs of a recruiting program to be conducted by USS. DOL refused to pay the costs of such a program, and, consequently, it formed no part of the contract. Now it appears that USS is trying to recover such costs by a "back door" approach, so to speak, by labeling the recruiting costs as a mitigation of damages for an alleged breach of contract.

It is obvious that USS undertook the recruiting program for its own financial gain. The more recruits it could get into the program, the more it could collect from the Government. It is undisputed that many of the original trainees did not

complete the full 195 day period. Indeed, USS claims the average was 99.8 days. Using this figure, it follows that had SES and CEP furnished referrals that resulted in one trainee for each of the 1,872 job slots in a timely fashion, USS would have been able to invoice DOL only $2,604,348.80 for those trainees (99.8 days times $13.94 per day times 1,872 trainees). Any amount invoiced over and above $2,604,348.80 is therefore logically attributable to days worked by replacement trainees. In fact, plaintiff's own records indicate that 581 trainees over and above the contract number of 1,872 were employed during the course of the contract, and plaintiff eventually received $3,448,368 under the contract. Because DOL had no obligation to furnish these excess trainees, USS had to find them on its own. It did so and as a result collected $884,019.20 more than it otherwise would have collected. Accordingly, it is unreasonable for plaintiff to assert that the cost of the special recruiting program was incurred solely because of defendant's alleged breach.

We hold that DOL did not breach the contract and plaintiff is not entitled to recover its damage claim of $50,083.95 nor the cost of its recruiting program in the sum of $70,753.

II

The Quantum Meruit Quasi Contract Claims

The plaintiff seeks recovery of the following claims on a quantum meruit or quasi contract basis:

(1) Cost of employing six additional head trainers—$135,954.00.

(2) Expenses of special (vestibule) training of trainees in addition to their required basic training—$227,069.00.

The plaintiff admits that these costs were not included in nor contemplated by the contract, but are costs and expenses completely outside of and beyond the terms of the contract. It seeks recovery of these costs on an alleged implied in law quantum meruit or quasi contract basis. This court is without authority to grant plaintiff relief on these claims for at least two reasons. In the first place, we do not have jurisdiction

under the Tucker Act (28 U.S.C. § 1491) of claims based on a contract implied in law (as distinguished from claims based on contracts implied in fact, which are within the jurisdiction of this court). Both the Supreme Court and this court have so held. *See Algonac Mfg. Co.* v. *United States*, 192 Ct. Cl. 649, 428 F. 2d 1241 (1970), where we held:

> This court does not have jurisdiction of claims based upon contracts implied in law. The Supreme Court said in *Merritt* v. *United States*, 267 U.S. 338,341 (1925):
>
> > * * * The Tucker Act does not give a right of action against the United States in those cases where, if the transaction were between private parties, recovery could be had upon a contract implied in law. * * *
>
> *See also J. C. Pitman & Sons* v. *United States*, 161 Ct. Cl. 701, 704–5, 317 F. 2d 366 (1963) and cases there cited. This court does have jurisdiction of claims based on contracts implied in fact. *See New York Mail & Newspaper Trans. Co.* v. *United States*, 139 Ct. Cl. 751, 759, 154 F. Supp. 271, 276 (1957), *cert denied*, 355 U.S. 904. [*Id.* at 674, 428 F. 2d at 1256.][1]

In the second place, no recovery can be awarded to the plaintiff on these claims based on contracts implied in law because it is well settled that there can be no implied contract where there is an express contract between the parties, as in the instant case. 17 C.J.S. *Contracts* § 5 (1963); *Carpenter* v. *Josey Oil Co.*, 26 F. 2d 442 (8th Cir. 1928). The Board so held in this case.

It should be remembered that the contract in issue here did not have a changes clause nor any other clause providing for an equitable adjustment of claims of the contractor. No such adjustment can be made in this fixed-price contract for plaintiff's extra-contractual performance. *United States* v. *Utah Construction & Mining Co.*, 384 U.S. 394 (1966); *Crown Coat Front Co.* v. *United States*, 386 U.S. 503 (1967).

The Board allowed the plaintiff $38,369.47 of the $227,069 claimed here for the special vestibule training program on

[1] For a discussion of the difference between a contract implied in fact and and one implied in law, see *Algonac* 192 Ct. Cl. at 673–74, 428 F. 2d at 1255–56.

the theory that it was due under the terms of the contract. We do not agree. The contract did provide for vestibule training, but in only one division or department, but this was accomplished before USS conducted the special training program.

Not only was the computation of the contractor's compensation explicitly fixed by the contract, the services the contractor was obligated to provide were also explicitly defined. As to vestibule training the contract provided as follows:

> 2. *Vestibule Training*
>
> Vestibule Training was formerly the life blood of manpower development in industry. This training will simulate on-the-job conditions in a large shop-type area.
>
> The participants will be involved in Vestibule Training for a total of 88 hours. They will attend this class four hours per day for four weeks and two days.
>
> Vestibule training will be designed for the entry level occupation and selected higher-level occupations in each of the ten participating divisions or departments in the mill. The ten units involved will be.
>
> 1. Coke Plant
> 2. Blast Furnaces
> 3. Steel Producing
> 4. Central Mills
> 5. West Mills
> 6. Hot Rolling
> 7. Sheet Division
> 8. Tin Division
> 9. General Services
> 10. Mason Department
>
> Each group of trainees will be placed in a vestibule training class being taught the entry-level occupation of *one of the above divisions or departments.* * * * [Emphasis supplied.]

The unit cost of the aforementioned vestibule training was $760.36, assuming 1,872 participants in the program. It is clear that the contract price did not authorize USS to train the recruits to work in more than one division or department, yet that is exactly what it did. The trainees had completed their training in one division or department as authorized by

the contract, for which USS had been paid, but USS could not put them to work as regular employees because of the General Motors strike. Rather than lay them off, USS gave them additional training in another division or department. This was clearly in addition to what was authorized by the contract and was outside of and beyond its provisions. Besides, it was clearly for the benefit of USS because the trainees would be more useful to USS when hired on a permanent basis.

Even after the Board had decided $38,369.47 of the special training program could be allowed as due under the contract, the plaintiff apparently did not agree, because thereafter it filed suit here for the entire $227,069 on a quantum meruit quasi contract basis, alleging in its petition:

> 30. In late September USS determined to give certain individuals *who had completed the 12-week training program—additional training* so that they would be qualified for jobs in sections of the mill which were not affected by the GM strike and so that they would not be laid off and lose faith in the program.
> 31. USS thus gave these individuals some 78,706.6 *additional* hours of training.
> 32. Individuals receiving the *additional training* were paid at the rate of $2.885 per hour which meant that USS incurred an additional $227,069 in wage payments *which were not contemplated under the contract and not included in the contract price.* [Emphasis supplied.]

Furthermore, in plaintiff's motion for summary judgment it stated:

> * * * The wage payments made to each trainee for each *additional* day of training *were not contemplated by the contract and not included in the * * * fixed unit cost.* They represented a straight out of the pocket expenditure by U.S. Steel.
>
> * * * * *
>
> * * * Accordingly, U.S. Steel is entitled to recover the costs of the special training program *under the doctrine of quasi-contract.* [Emphasis supplied.]

Of course, the Board did not have the benefit of these allegations in plaintiff's petition filed in this court following

the Board's decision. The Board was no doubt influenced by a letter from Assistant Secretary of Labor for Manpower, Malcolm R. Lovell, Jr., dated May 1, 1972, long after the completion of the contract, which stated, among other things:

> * * * Therefore, the Manpower Administration *could entertain* an additional invoice of $38,369.47 (78,706.6 x $0.4875). [Emphasis supplied.]

This letter was a gratuitous statement made after the completion of the contract and was entirely without consideration. If it had any effect, it was an offer to compromise the claim, which was not accepted. The letter did not modify or change the executed contract under the disputes clause.

The Board allowed the $38,369.47 as being within the terms of the contract, because the additional training benefited the trainees and the Government and represented services rendered to accomplish the purpose of the contract.

This decision of the Board was an erroneous interpretation of the contract, which is a question of law, and we are not bound by its decision. The Board apparently lost sight of the fact that the contract was a fixed-price contract that contained specific provisions governing the rights and duties of the parties. As stated above, there was no changes clause or other clause in the contract providing for any kind of an equitable adjustment for the contractor. Under these circumstances, the only way the Government could pay USS for the additional training program outside of the contract would have been for the contracting officer to have modified or changed the contract. The contract was never changed nor modified in this regard.

Plaintiff now contends that the defendant cannot contest the Board's award to it of the $38,369.47 because of the decision in *S & E Contractors, Inc.* v. *United States*, 406 U.S. 1 (1972). We do not agree. In the first place, USS has not agreed to accept the $38,369.47 in full settlement of its claim of $227,069 for the special training program. In this suit it seeks to collect the entire $227,069 of which the $38,369.47 is a part. By suing here for the balance of the claim, the plaintiff has kept the dispute alive that involves the entire

claim. Under these circumstances, the defendant has every right to challenge the award of $38,369.47 made by the Board. This was the effect of our holding in *Roscoe-Ajax Construction Co.* v. *United States*, 204 Ct. Cl. 726, 499 F. 2d 639 (1974). Since the plaintiff has appealed a part of a disputed claim, the defendant has the right to appeal and contest the rest of the same claim.

We conclude that the plaintiff is not entitled to recover on its quantum meruit quasi contract claims of $135,954 for six extra head trainers and $227,069 for the extra basic training of the trainees. We reverse the decision of the Board as to the $38,369.47 which it awarded to the plaintiff as a part of the claimed $227,069.

The plaintiff's motion for summary judgment is denied, defendant's motion for summary judgment is granted, and plaintiff's petition is dismissed.

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537 F. 2d 405

FREDERICK H. VOGT v. THE UNITED STATES

[No. 427–74. Decided June 16, 1976]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; income tax; income from foreign sources; foreign-resident partner; Sec. 911 exclusion.—In 1969 and 1970 plaintiff, a United States citizen, was a partner in a Danish accounting firm and had been a resident of Denmark for more than 3 years. He seeks refund of Federal income taxes for said years, claiming entitlement pursuant to Secs. 911(a) (1) and (c) (1) (B) of the Internal Revenue Code of 1954 to exclude $25,000 of earned income from the computation of his tax. The case is before the court on a stipulation of facts. Plaintiff contends that the exclusion is to be applied against his share of partnership net income for said tax years; defendant contends that the exclusion is to be applied against plaintiff's allocable share of partnership gross income for those years, with disallowance of a corresponding portion of his allocable share of partnership expenses. The court reviews the legislative background of Sec. 911, its administrative interpretation manifested in revenue rulings, regulations and Tax Guides up to 1968 and thereafter, and judicial interpretations. It is *held* that plaintiff has demonstrated that the long-standing administrative interpretation related a partner's earned income to his share of partnership net income. The net income interpretation for partners, contemporaneous with the first statutory imposition of limits on the amount excludable and main-

Syllabus

tained for many years through changes in the statute, fixed the meaning of Sec. 911 for this taxpayer during the years in suit. In the light of the ambiguity of Sec. 911, that interpretation was clearly reasonable. Plaintiff's motion for summary judgment is granted, defendant's cross-motion is denied, and the case is remanded for further proceedings under Rule 131(c) to determine the amount of plaintiff's recovery with any offset to which defendant may be entitled taken into account.

Statutes; construction and operation; administrative interpretation.

[1] The construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong.

Statutes ⇐ 219(1)

Statutes; construction and operation; administrative interpretation.

[2] To sustain a contemporaneous administrative construction of a statute, a court need not find that the administrator's construction is the only reasonable one or that which the court would have reached; the construction need only be reasonable in itself.

Statutes ⇐ 219(1)

Taxes; income tax; income subject to taxation; income from foreign sources; partnership earned income.

[3] Although Sec. 185 of the Internal Revenue Code of 1939 providing that earned income of partners was to be determined by reference to the partnership's earned income was repealed and not made part of Sec. 911 of the 1954 Code or regulations thereunder, it demonstrates that earned income has not always been a gross income concept and that a net profit interpretation of earned income is reasonable in the partnership context.

Internal Revenue ⇐ 831

Taxes; income tax; income subject to taxation; income from foreign sources; partnership earned income; Sec. 911 exclusion; legislative construction.

[4] Section 911(a)(1) and (c)(1)(B) exclude from gross income and exempt from tax $25,000 of foreign-source earned income received by a United States citizen who has been a bona fide resident of a foreign country for more than 3 years. However, neither the statute nor the legislative history provides a sure footing on which to resolve the question whether a partner's earned income is his share of partnership net income or his allocable share of partnership gross income.

Internal Revenue ⇐ 315

Taxes; income tax; income subject to taxation; income from foreign sources; partnership earned income; Sec. 911 exclusion; administrative construction.

[5] According to the Tax Guide for U.S. Citizens Abroad, applicable forms, revenue rulings and disputes with taxpayers in various courts, at least through 1968 it was the well-established rule of the

Internal Revenue service that a foreign-resident partner's earned income was a proper part of his share of the partnership's foreign-source net income. The minor alterations effected in 1969 in Form 2555, accompanying instructions and the Tax Guide, which were unclear and ambiguous, were inadequate to effect a turnabout in the long-standing interpretation which had prevailed theretofore.

Internal Revenue ⟸ 140, 315

Statutes; construction and operation; judicial interpretation; income subject to taxation; income from foreign sources; Sec. 911 exclusion.

[6] In determining whether a foreign resident-partner's $25,000 exclusion of earned income is to be applied against his share of partnership net income (taxpayer's position) or against his allocable share of partnership gross income (defendant's position), broad statements in judicial opinions cited by defendant and resting on situations which were exceptional and in which the holdings were necessary to prevent the deduction of foreign expenses from U.S.-source income, cannot prevail against the mass of directly apposite authority presented by taxpayer.

Internal Revenue ⟸ 315

Taxes; Revenue Rulings; retroactivity of rulings.

[7] A revenue ruling which does not state that it is retroactive in its application, which conflicts with an administrative interpretation in effect during the tax years in issue and which adversely affects the taxpayer, will not be applied by the court to litigation which began before the ruling was issued.

Internal Revenue ⟸ 154

George G. Tyler, attorney of record, for plaintiff. *Cravath, Swaine & Moore* and *Peter C. Canellos*, of counsel.

Joan Seitz Pate, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Robert S. Watkins*, of counsel.

Before DAVIS, NICHOLS, and BENNETT, *Judges*.

DAVIS, *Judge*, delivered the opinion of the court:

In 1969 and 1970 plaintiff, a United States citizen, was a partner in a Danish accounting firm and had been a resident of Denmark for more than three years. As such, he was entitled by the Internal Revenue Code of 1954, §§ 911(a)(1), (c)(1)(B), to exclude $25,000 of earned income from the computation of his United States income tax. The sole issue now before us in this tax refund suit, raised by the parties'

cross-motions for summary judgment, is whether the $25,000 exclusion is to be applied against plaintiff's share of partnership net income for 1969 and 1970 (plaintiff's position) or against his allocable share of partnership gross income for those years, with disallowance of a corresponding portion of his allocable share of partnership expenses (the Government's position). The parties have provided us with a stipulation of the facts pertinent to this question. Not covered by the stipulation nor before us at this time is an offset issue raised by the Government. It is agreed that this issue will be moot if the Government prevails on its motion for summary judgment but will have to be tried if the plaintiff wins here.

The simple facts are that taxpayer was a bona fide resident of Denmark for an uninterrupted period including January 1, 1966 through December 31, 1970. For the tax years in issue, 1969 and 1970, he was a partner in a Danish accounting firm, the gross income of which consisted entirely of fees received for services rendered outside the United States. In 1969 plaintiff's allocable shares of the partnership's gross income, expenses, and net profits were $348,611, $243,850, and $104,761 respectively. In 1970 his shares were $470,045, $337,121, and $132,924.

In his tax returns for 1969 and 1970, plaintiff excluded $25,000 of his distributable share of partnership net profits as earned income attributable to services performed while a bona fide resident of a foreign country. Upon audit, the Internal Revenue Service disallowed the exclusion of $25,000 of net profits and substituted an exclusion of $25,000 of plaintiff's allocable share of the partnership's gross income. In that connection the Service disallowed the deduction of the portion of plaintiff's allocable share of partnership expenses that was attributable to the excluded gross income. The effect of these adjustments was to increase plaintiff's taxable income by the amount of disallowed expenses.[1] Plaintiff paid

[1] The following summary of the parties' calculations demonstrates the differences between the methods of computation:

	1969	1970
Plaintiff's share of partnership gross income	$348,611	$470,045
Plaintiff's share of partnership expenses	−243,850	−337,121
Plaintiff's share of partnership net income	104,761	132,924

(Continued)

the deficiencies resulting from the Service's recomputation, filed proper refund claims, and timely filed suit in this court after disallowance.

I

The Internal Revenue Code of 1954, in sections 911(a)(1) and (c)(1)(B), excludes from gross income and exempts from tax $25,000 of foreign-source earned income received by a United States citizen who has been a bona fide resident of a foreign country for more than three years.[2] As we have

(Continued)

Plaintiff's method of computation:		
Share of partnership net income	104,761	132,924
Less $25,000 exclusion	−25,000	−25,000
	79,761	107,924
Service's method:		
Share of partnership gross income	348,611	470,045
Less $25,000 exclusion	−25,000	−25,000
Reportable income	323,611	445,045
Deduction of share of partnership expenses:		
Portion of expenses disallowed as attributable to excluded income	25,000	25,000
	348,611	470,045
Expenses disallowed	17,484	17,935
Expenses allowed	226,366	319,186
Reportable income less allowed expenses	97,245	125,859
Difference in income subject to tax under the two methods:		
Service's method	97,245	125,859
Plaintiff's method	−79,761	−107,924
	17,484	17,935

[2] Section 911 provides, in pertinent part:

(a) General rule.

The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) Bona fide resident of foreign country.

In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such uninterrupted period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

* * * * *

An individual shall not be allowed, as a deduction from his gross income, any deductions (other than those allowed by section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this subsection.

(b) Definition of earned income.

For purposes of this section, the term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a rea-

said, we must determine whether the $25,000 of earned income excluded and exempt is $25,000 of a partner's share of partnership net profits, as plaintiff contends, or $25,000 of his share of partnership gross income, as the defendant urges. The Government asserts that the statute is clear and unambiguous and mandates the gross income interpretation. In its view, the section is structured in terms of gross income rather than net profits, and earned income, the income designated as eligible for exclusion, "[h]istorically * * * has always been a gross income concept." The defendant concludes that the $25,000 excludable must be $25,000 of gross income, which in the case of a partner is his allocable share of partnership gross income. INT. REV. CODE of 1954 §§ 61(a)(13), 702(c). The Service finds further support for its position in the last sentence of section 911(a), disallowing deductions properly attributable to amounts excluded from gross income.

The plaintiff counters with emphasis on the statute's use of "and shall be exempt from taxation" and with quotations from committee reports showing Congress's focus on the amount exempt from taxation; he points out that under the Government's method the amount exempt from taxation, where the taxpayer is a partner, is less than $25,000 by the sum of disallowed deductions.[3] He also disputes the Govern-

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sonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary or his delegate, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

"(c) Special rules.

For purposes of computing the amount excludable under subsection (a), the following rules shall apply:

(1) Limitations on amount of exclusion.

The amount excluded from the gross income of an individual under subsection (a) for any taxable year shall not exceed an amount which shall be computed on a daily basis at an annual rate of—

* * * * *

(B) $25,000 in the case of an individual who qualifies under subsection (a)(1), but only with respect to that portion of such taxable year occuring [sic] after such individual has been a bona fide resident of a foreign country or countries for an uninterrupted period of 3 consecutive years.

[3] *See* note 1 *supra*. With respect to the amount exempt from tax, plaintiff has graphically illustrated the discrimination between partners and employees

(Continued)

ment's claim that earned income has always been a gross income concept. Most importantly, however, the taxpayer has given us numerous examples of the Service's application of the section 911 exclusion against a partner's distributive share of partnership net income and ultimately rests his case on the assertion that he followed the long-standing administrative interpretation, which fixed the meaning of section 911, when he carved out $25,000 of his share of the partnership's net profits.

II

If the plaintiff has accurately assessed the prevailing administrative practice and interpretation, as we believe he has,[4] we must hold for him unless the statute clearly and unambiguously demonstrates that the "partner's share of net profits" interpretation was wrong and mandates the gross income interpretation now urged by the Government. *See*,

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(Continued)
receiving equal "salaries" which would result from the Government's interpretation. As shown by the following chart, an employee receiving $25,000 would be allowed to exclude the entire sum while partners receiving $25,000 would have to report as income subject to tax the amounts of disallowed partnership deductions.

	Employee	Partner A	Partner B	Partner C
Amount received	$25,000	$25,000	$25,000	$25,000

Partner *A* is a 50% partner in a partnership having $100,000 gross income and $50,000 expenses. Partner *B* is a 50% partner in a partnership having $200,000 gross income and $150,000 expenses. Partner *C* is a 50% partner in a partnership having $400,000 gross income and $350,000 expenses. *A's* partnership has a high level of profit, *C's* a low level.

Partners' shares of gross income	$50,000	$100,000	$200,000
Partners' shares of expenses	25,000	75,000	175,000
Government's method of calculation:			
Gross income	$25,000	50,000	100,000	200,000
Less $25,000 exclusion	−25,000	−25,000	−25,000	−25,000
	0	25,000	75,000	175,000
Deduction of partnership expenses not disallowed		−12,500	−56,250	−153,125
Reportable adjusted gross income (equal to disallowed expenses)	0	12,500	18,750	21,875

This chart shows not only discrimination between employees and partners receiving equal amounts; the member of the least profitable partnership has the greatest amount of income subject to tax. Thus, the Government's method results in discrimination among taxpayers employing the same method of doing business, with the tax burden bearing an inverse relationship to the profitability of the business.

[4] *See* part III *infra*.

e.g., *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969) (the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong); *Udall* v. *Tallman*, 380 U.S. 1, 16, 18 (1965) (to sustain a contemporaneous administrative construction of a statute, a court need not find that the administrator's construction is the only reasonable one or that which the court would have reached; the construction need only be reasonable in itself). But as we now show in this part of our opinion, we do not see sufficient clarity in the statute or in its legislative history to override, for the tax years at issue, the interpretation by those charged with the statute's administration, applied consistently for many years.

Section 911 does not specifically address the partnership situation and, contrary to the Government's contention, is not structured around gross income. Although it does state, "The following items shall not be included in gross income," it continues by saying, "and shall be exempt from taxation." The amount to be excluded and exempt is described as "amounts received * * * which constitute earned income," not as gross income or as gross income which constitutes earned income. Further, earned income is not defined in a way that makes it necessarily equivalent to gross income; the definition does not use "gross income" and instead expressly links the earned income of one group of taxpayers to net profits.[5] Looked at as a whole, the pertinent portions of the statute pair the exclusion from gross income with exemption from taxation, use "amount excluded from gross income" as a shorthand reference to the amount excluded and exempt, and designate "earned income" as the controlling concept.

In the Government's submission, however, the use of "earned income" is sufficient to require a gross income interpretation because earned income "[h]istorically * * * has

[5] The definition of earned income lists several categories of income, not received by plaintiff, and provides a general description—"amounts received as compensation for personal services actually rendered." The remainder of the definition focuses on the concept of reasonable compensation for services rendered and measures reasonable compensation against net profits where the taxpayer's income derives from a service-and-capital business. *See* note 6 *infra* and accompanying text.

always been a gross income concept." This pronouncement is demonstrably incorrect in the partnership context and otherwise overstated. In section 911 itself, the earned income of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors is tied to net profits, not to gross income.[6] In contexts other than the foreign-source income exclusion, net profits or net income definitions of earned income have surfaced. *See, e.g., Warren R. Miller, Sr.*, 51 T.C. 755, 762–63 (1969) (for purposes of the section 37 retirement income credit, which incorporates the section 911 definition of earned income, earned income is net profits in the self-employment situation); INT. REV. CODE OF 1954, § 401(c)(2)(A) (for purposes of rules governing qualified pension and other plans for self-employed and owner-employees, the term "earned income" means net earnings from self-employment).[7] Most significantly, section 209 of the Revenue Act of 1924, creating an earned income credit, specifically stated: "In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership * * *."[8] Though separated from the general earned income

[6] The parties stipulated that capital is not a material income-producing factor in the trade or business of plaintiff's accounting firm, so this provision does not command us to look to net profits in this particular case. However, as the Tax Court observed in an opinion interpreting section 37, which incorporates the section 911 definition of earned income: "In the case of a taxpayer 'engaged in a trade or business in which both personal services and capital are material income-producing factors,' however, earned income is keyed to the 'net profits of such trade or business,' not to the gross profits thereof. There is nothing in the language of the section to suggest that, in the case of a 'trade or business' in which capital is not a material income-producing factor but in which expenses are substantial, the focus should be on gross, rather than net, profits." *Warren R. Miller, Sr.*, 51 T.C. 755, 762 (1969).

[7] "Net earnings from self-employment" is defined, in section 1402(a) of the Code, as the gross income of a trade or business carried on by an individual, less the deductions attributable to the trade or business, plus the individual's distributive share of the section 702(a)(9) taxable income or loss from the trade or business carried on by a partnership of which he is a member.

[8] Revenue Act of 1924, ch. 234, § 209(c), 43 Stat. 264. Subsection (c) in effect supplemented subsection (a)(1), the general definition of earned income, which was almost identical to the definition of earned income which now appears in section 911(b). *Compare id.* § 209(a)(1) *with* INT. REV. CODE OF

credit provision and placed with the partnership sections in the "supplemental provisions" of the 1928 and later revenue acts, this statute remained part of all revenue acts and the 1939 Code until the earned income credit was repealed,[9] and it established the composition of a partner's earned income for that period. We do not give conclusive effect to this old statute, though we think, with the Second Circuit, that "the rule it established is [a] natural way to interpret the foreign earned income exclusion in the partnership context." [10] But this older piece of legislation [11] and the others previously mentioned do demonstrate that earned income has not always

1954, § 911(b). Section 209 of the 1926 Revenue Act, unchanged in its material respects from section 209 of the 1924 Act, fixed the meaning of earned income for the purposes of the original version of section 911. *See* Revenue Act of 1926, ch. 27, § 213(b)(14), 44 Stat. 26. Thus, section 209(c) is in essence part of the legislative history of section 911 and not merely a portion of an old statute happening to use the very term that is the key to section 911.

The regulation under section 209(c) read: "The earned income credit will be allowed to the members of a partnership with respect to the share of the net income belonging to each which consists of earned income." Treas. Reg. 65, art. 1661 (1924). Later regulations under this statute, which became section 185 of the 1928 and later revenue acts, declared bluntly that "a member of a partnership is entitled to treat a proper part of his distributive share of the partnership net income as earned income." *E.g.*, Treas. Reg. 101, art. 185–1 (1939).

[9] *See* Revenue Act of 1928, ch. 852, § 185, 45 Stat. 841; Revenue Act of 1932, ch. 209, § 185, 47 Stat. 223; Revenue Act of 1934, ch. 277, § 185, 48 Stat. 730; Revenue Act of 1936, ch. 690, § 185, 49 Stat. 1709; Revenue Act of 1938, ch. 289, § 185, 52 Stat. 522; Int. Rev. Code of 1939, ch. 2, § 185, 53 Stat. 70; Revenue Act of 1943, ch. 63, § 107(a), 58 Stat. 31 (1944) (repealing the earned income credit). Section 185 was included in the Revenue Act of 1932, even though the earned income credit was omitted from that Act and the definition of earned income that had appeared in the earned income credit provision was transferred to the predecessor of section 911. *See* Revenue Act of 1932, ch. 209, §§ 116(a), 185, 47 Stat. 204, 223 (exclusion of foreign-source earned income; partner's earned income); Revenue Act of 1928, ch. 852, § 31, 45 Stat. 804 (earned income credit and definition of earned income which was transferred to section 116(a) in 1932).

[10] *Foster* v. *United States*, 329 F. 2d 717, 719 (2d Cir. 1964). We cannot give conclusive weight to the old section because the statute was repealed and its contents were not made a part of section 911 or the regulations thereunder.

[11] The Government in effect conceded the relevance of section 209(c), *supra*, when it cited section 209(a) of the 1924 Revenue Act as support for its argument that earned income has always been gross income. As the Government pointed out, section 209(a) defined not only "earned income" but also "earned income deductions" and "earned net income." However, if the Government's analysis of section 209(a) was intended to suggest that under that statute the plaintiff's share of partnership gross income would have been "earned income," his share of partnership expenses "earned income deductions," and his share of partnership net income "earned net income," the Government erred. Section 209(c) plainly referred to the share of partnership net income (a proper part thereof) as the earned income of a partner, not as his earned net income.

been a gross income concept, that a net profit interpretation of earned income is reasonable in the partnership context, and that there is a crucial gap in the very statute (current section 911) which the Government wants us to declare so clear that even a long-standing administrative construction cannot stand against the statutory text.

There remains one other Government argument based on the words of section 911(a). Calling our attention to the last sentence, which requires disallowance of any deductions properly allocable to or chargeable against amounts excluded from gross income, the defendant tells us that the plaintiff's net income interpretation effectively abrogates this provision in the partnership situation. The primary weakness of this argument is that it presupposes the answer to the issue before us. The Government's application of the last sentence of section 911(a) would certainly be correct if the earned income excludable by a partner were plainly his share of partnership gross income, for partnership expenses attributable to excluded gross income would surely have to be excluded with the gross income. However, if the earned income to be excluded by a partner is his share of partnership net income, there are no partnership expense deductions to be taken or disallowed, just as there may be no expenses in the case of an employee (*see* note 3 *supra*). In short, the application of the last sentence of section 911(a) can be understood as merely following from the delineation of the earned income to be excluded; that sentence does not really clarify the statute which is unclear in its controlling segments.[12]

[12] The plaintiff has made another significant attack on the importance the Government seeks to attach to the last sentence—the disallowance-of-deductions statement—in section 911(a). That statement, worded just as it is today, has been part of the foreign-source income exclusion from its inception in 1926. *See* Revenue Act of 1926, ch. 27, § 213(b)(14), 44 Stat. 26. In its early years, the provision could not have had the import now assigned to it by the Government, for a number of reasons. As the plaintiff emphasizes, from 1926 to 1952 (and to 1962, for some taxpayers) all foreign-source earned income of taxpayers meeting the statutory prerequisites was excluded, so the only purpose of the disallowance-of-deductions provision was to preclude the deduction of expenses incurred in earning foreign-source income from unearned income or from United States-source income. Further, the regulations implementing the deduction disallowance prior to 1957 recognized implicitly that amounts other than gross income could be excluded earned income and that in

Thus, we find the statute unclear, containing elements that lend support to the positions of both parties and elements of inadequate definition. To the extent that the legislative history elucidates section 911, it appears to give somewhat greater support to the plaintiff than to the Government.[13] Neither the statute nor the legislative history, however, gives us a sure footing on which to resolve the question whether a partner's earned income is his share of partnership net income or his allocable share of partnership gross income.

III

Since we have ruled against the Government on the clarity of section 911 and remain in doubt on the reading to be given the text of the statute, we turn to the administrative interpretation.[14] That construction has received extensive atten-

such instances the deduction disallowance provision did not come into play. Those regulations said, "In any case in which any amount otherwise constituting gross income is excluded from gross income under the provisions of section 116(a), there shall not be allowed as a deduction from gross income any items of expenses or losses or other deductions properly applicable to or chargeable against the amounts so excluded from gross income." *E.g.*, Treas. Reg. 118, § 39.116–1(a)(3) (1953). Finally, until 1944 the Acts and Code expressly provided that a partner's earned income was a proper part of his share of partnership net income (see notes 8–9 *supra* and accompanying text), so the disallowance-of-deductions statement could not have affected his share of partnership expenses, as the Government would now have it do. Nothing in the statute or legislative history indicates that the impact of the disallowance-of-deductions sentence has changed, and the adoption of plaintiff's method will not permit the deduction of expenses attributable to excluded earned income from nonexcluded earned income, or from unearned income, in violation of the original purpose of what is now the last sentence of section 911(a).

[13] Additional support for plaintiff can be found in the congressional reports quoted by plaintiff, because in those and other documents Congress demonstrated that its primary concern was the amount of income that escaped taxation. We shall not analyze the reports because they contain nothing directly on point and they are perhaps more confusing than clarifying. For example, one report referred to exclusion from taxable income. *See* S. REP. No. 1881, 87th Cong., 2d Sess. 76 (1962). The plaintiff ascribes great significance to this reference, but it clearly does not comport with the words of the statute and may reflect carelessness rather than the Committee's careful understanding of the operation of the provision.

[14] We must look to sources other than the regulations under section 911, for those regulations do not assist us in resolving the partner's earned income issue. They add little to the statute, suffer from the same omissions and lack of clarity, and do not treat the partnership situation in text or examples. They do contain one provision which appears to favor the Government somewhat. *See* Treas. Reg. § 1.911–2(c)(2) (1963) (the entire amount received as professional fees by a taxpayer engaged in a professional occupation shall be treated as earned income under certain circumstances). However, the applicability of this limited section to the plaintiff is not clear enough to solve our problem in this case. *See* note 26 *infra*.

tion from the taxpayer, who contends that, prior to challenging plaintiff's returns for 1969 and 1970 and the issuance of a contrary revenue ruling in 1975 (after this litigation had been begun), the Service consistently applied the net profits interpretation urged and followed by plaintiff.

A

Of most immediate significance are the forms and the *Tax Guide for U.S. Citizens Abroad* (I.R.S. Publication No. 54) given taxpayers by the Service. Through 1968, Form 2555, entitled "Statement to Support Exemption of Income Earned Abroad," listed these items under earned income: wages, salaries, bonuses, commissions, etc.; pensions and annuities; *allowable share of net profit for personal services rendered* in a business, in a profession, in farming, *in a partnership;* other income; allowances or reimbursements. The instructions included with the form did not amplify this clearly worded list of items to be included in earned income; they simply restated the statute's general definition of earned income and the statute's sentence governing a taxpayer engaged in a trade or business in which both services and capital are material income-producing factors, and added, in boldface capitals, examples of items that are not earned income. Like the form, the *Tax Guide for U.S. Citizens Abroad* explicitly treated a partner's share of partnership net profit, not of partnership gross income, as the sum to be considered in determining the partner's excludable earned income; the *Guide*'s examples designed to illustrate the calculation of a partner's earned income all centered on the partnership net profits and the partner's share thereof.[15]

[15] In one especially apt example, the first on page 15, the 1968 edition of the *Guide* declared: "You and another taxpayer are management consultants and operate as an equal partnership in performing your services outside the United States. Since capital is not an income-producing factor, all the net profits from the partnership will be considered earned income." This example followed the statement that the 30-percent-of-net-profits limitation does not apply where only personal services, not capital, produce the income and demonstrated that through 1968 the Service shared the later-expressed Tax Court view that even when the 30 percent limit does not apply, the focus remains on net profits of a taxpayer engaged in a trade or business. *See* note 6 *supra.*

The Service has treated a partner's share of net income as the pertinent sum not only in the forms and in the *Tax Guide* but also in disputes with taxpayers in this and other courts. *See Carey* v. *United States*, 192 Ct. Cl. 536, 540, 543–46, 427 F. 2d 763, 765–66 (1970); *Andrew O. Miller, Jr.*, 52 T.C. 752, 756–57 (1969), *acquiesced in*, 1972–2 CUM. BULL. 2; *Foster* v. *United States*, 221 F. Supp. 291, 292–93 (S.D.N.Y. 1963), *aff'd*, 329 F. 2d 717 (2d Cir. 1964); *Thomas Browne Foster*, 42 T.C. 974 (1964); *cf. Daniel A. Robida*, 29 CCH Tax Ct. Mem. 407 (1970), *aff'd*, 460 F. 2d 1172 (9th Cir. 1972) (Commissioner applied $20,000 exclusion against adjusted gross income of "sole proprietor"). In each of these cases the Government and the partner disputed only the allocation, between foreign-source and United States-source income, of the partner's distributive share of partnership net income or of the amount actually received by the partner. The Government neither based its calculations on nor mentioned the partner's allocable share of partnership gross income.[16]

Buttressing this evidence of the Service position at least through 1968 are revenue rulings interpreting section 911 (and another provision in which section 911 plays a minor role) and regulations under the Code's partnership provisions. These rulings and regulations are more suggestive than explicit or conclusive, but they add to the force of plaintiff's arguments and analysis. They show that the Service has consistently assumed the net profits understanding of section 911 "earned income."

Revenue Ruling 55–171, 1955–1 CUM. BULL. 80, *declared obsolete*, Rev. Rul. 72–621, 1972–2 CUM. BULL. 651, listed two types of income under the heading "earned income"—compensation for personal services rendered and profit from trade or business. In stating and illustrating the 30-percent-

[16] Although in *Thomas Browne Foster, supra*, the Tax Court used the phrase, "distributive share of partnership gross income," the figures and language used make clear that the Commissioner and court dealt only with the amount Foster actually received from the partnership. Foster's 4.08 percent of the partnership's gross income of $473,812.81 would have amounted to over $19,000. The Commissioner and court concerned themselves only with how much of the $14,115.06 actually received by Foster was excludable as foreign-source income.

of-net-profits limitation where both capital and personal services are income-producing factors, the ruling said: "The balance of the profits must be included in gross income for Federal income tax purposes." *Id.* § 7, 1955–1 CUM. BULL. at 87. The implication is that the balance of net profits would not be included in gross income but for the 30 percent limit applicable because of the role of capital.[17] Revenue Ruling 67–158, 1967–1 CUM. BULL. 188, concluded that, where capital is not a material income-producing factor, "each partner's distributive share of that portion of partnership income representing compensation for services rendered by the partnership is 'earned income.' " In the only place in which the ruling referred to each partner's distributive share in the terms with which we are concerned, the ruling specified "distributive share of net partnership income." *Id.*, 1967–1 CUM. BULL. at 190, 189. Revenue Ruling 70–491, 1970–2 CUM. BULL. 92, interpreting section 401 of the Code, contains this statement: "Thus, under the provisions of section 1.401–10(c)(2) of the regulations and section 911 of the Code, up to $25,000 of net earnings is excluded from gross income and, consequently, does not constitute earned income under section 401(c)(2)." If the Service had viewed section 911 as it does now, the revenue ruling would have read, "Thus, under section 911 of the Code, up to $25,000 of gross income is excluded from gross income, and, under section 1.401–10(c)(2) of the regulations, the net earnings derived from this excluded gross income do not constitute earned income under section 401(c)(2)."[18] Finally, in Revenue Ruling 57–142, 1957–1 CUM. BULL. 246,

[17] This interpretation of Revenue Ruling 55–171 accords with the 1968 *Tax Guide for U.S. Citizens Abroad. See* note 15 *supra.*

[18] The Government insists that we cannot read Revenue Ruling 70–491 strictly because that ruling deals primarily with section 401(c)(2), which defines earned income as net earnings from self-employment, and only tangentially with section 911. However, the ruling was issued to advise a self-employed United States citizen who was a resident of a foreign country on the interrelation of sections 911 and 401 because a regulation under section 401 excluded from earned income amounts excluded from gross income under other Code provisions. The Service certainly should have focused on a correct analysis of section 911 as necessary to proper advice to such a taxpayer. If it did not focus on section 911, the explanation may well be that it considered the meaning of section 911 too well settled to require special attention. *See Fribourg Navigation Co.* v. *Commissioner,* 383 U.S. 272, 280 (1966).

revoked on other grounds, Rev. Rul. 66–326, 1966–2 CUM. BULL. 281, the Service stated the question as whether the earned income of a citizen operating a truck farm in Mexico was limited by the 30-percent rule or was his entire net earnings.

The regulations under two partnership provisions offer plaintiff some additional support. Section 1.702–1(c) lists numerous situations in which a partner must take into account his share of partnership gross income. This list does not include section 911, though the same regulation, four paragraphs earlier, requires the earned income of the partnership to be separately stated for all partners if any partner is a bona fide resident of a foreign country who may exclude, under section 911, the part of his distributive share which constitutes earned income. Treas. Reg. § 1.702–1(a)(8)(ii).[19] Example 2 in section 1.704–1(b)(2) declares that the Service ordinarily will recognize a partnership agreement allocating to a partner who is a resident of a foreign country a percentage of the profit derived from his operations in the foreign country greater than his distributive share of partnership income generally. This suggests once again that profit, not gross receipts, is the significant figure for a foreign resident partner.

B

Against this weighty evidence of an administrative interpretation coinciding with plaintiff's net profit construction the Government pits two cases, changes made in 1969 in form 2555 and in the *Tax Guide for U.S. Citizens Abroad*, and Revenue Ruling 75–86, 1975–1 CUM. BULL. 242.[20] In addition, the Government, in oral argument, labeled the net profits

[19] This regulation calls to mind the similar requirement in section 185 of the 1939 Code that earned income be separately stated for all partners. Section 185 was the statute which defined a partner's earned income as a proper part of his distributive share of partnership net income. *See* notes 8–9 *supra* and accompanying text.

[20] As already mentioned, the Government has placed its primary reliance on the statute and the maxim that an erroneous administrative interpretation can neither change the meaning of a clear statute nor excuse a taxpayer's obligation to pay the tax imposed by the statute. We have already determined (Part II, *supra*) that the statute is unclear and this principle is inapplicable.

emphasis in the forms and tax guides prior to 1969 as a mistake and a hangover from the years before monetary limits were placed on the amount excludable,[21] when it mattered not whether the exclusion related to gross income or to net profits.

To take up first the last of these comments, the forms and guides cannot be dismissed so easily. The first monetary limitation on the amount of earned income excludable was imposed, against those merely present rather than resident abroad, in 1953. Form 2555 (used by taxpayers who meet the presence test and also by those coming under the residence test) as well as the tax guides continued the treatment of net profits as earned income for many years after 1953 and cannot be put down as mere careless hangovers. Moreover, all the other sources cited above (Part III, A), which the Government did not attempt to dismiss as hangovers, relate to the years after the first limit took effect and represent the interpretation contemporaneous with the statutory changes.[22]

The two cases relied on by the Government, *Frieda Hempel*, 6 CCH Tax Ct. Mem. 743 (1947) and *Brewster* v. *Commissioner*, 473 F. 2d 160 (D.C. Cir. 1972), *aff'g* 55 T.C. 251 (1970), do not bear the weight placed on them. Both cases involved individuals (one an opera singer and the other a farmer), not carrying on business in the partnership form, who suffered losses in their foreign endeavors and sought to

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[21] For the most of its history, the foreign-source income exclusion reached all the foreign-source income of a citizen who met the residence or nonresidence requirements. Only in 1953 was the first monetary limit placed on the amount of earned income excludable; in 1953 a $20,000 limit was placed on the amount excludable by one who met the foreign presence, not the foreign residence, requirement. Technical Changes Act of 1953, ch. 512, § 204, 67 Stat. 618. In 1962 similar limitations were placed on the amount excludable by a resident of a foreign country—a $20,000 limitation was effective during the first three years of foreign residence, and a $35,000 limitation took effect after those three years. Revenue Act of 1962, Pub. L. No. 87–834, § 11, 76 Stat. 1003. In 1964, the $35,000 limit applicable after three years was reduced to $25,000. Revenue Act of 1964, Pub. L. No. 88–272, § 237, 78 Stat. 128.

[22] For example, Revenue Ruling 55–171, 1955–1 CUM. BULL. 80, issued shortly after the enactment of the limit on the amount excludable by one merely present abroad, clearly did not contemplate the application of a different meaning of earned income to those for whom the limitation was effective. *Id.* §§ 4, 5, 7, 1955–1 CUM. BULL. at 82, 83, 87; *see* text at note 17 *supra*.

apply those losses as deductions from U.S.-source income. Although in both cases the courts held that part or all of the gross receipts had to be excluded as earned income and that the expenses had to be excluded to the same extent, the facts are quite distinguishable from the set now before us. As these courts recognized, the situations were exceptional; the holdings were necessary to prevent the deduction of foreign expenses from U.S.-source income.[23] Broad statements in opinions resting on such different facts and policies cannot prevail against the mass of directly apposite authority presented by plaintiff.

Similarly, the 1969 changes in form 2555 and the *Tax Guide for U.S. Citizens Abroad* were inadequate to alter the by then well established administrative rule that a partner's earned income was a proper part of his share of the partnership net income. The pertinent change in the form itself consisted of the substitution of "income" for "net profit" in the line which had named "allowable share of net profit for personal services rendered in a partnership" as a type of earned income. Neither the form nor the instruction to which the form referred suggested whether "income" meant gross income, net or adjusted gross income, or amount received, and neither was altered in any way that would have alerted the taxpayer to the significance of the change in wording.[24] The only amendments in the *Tax Guide* were isolated substitutions of terms in the segment of the *Guide* headed "Profit from Trade or Business: Sole Proprietorship or Partnership." [25] In only one place was "gross income" substituted for "net profits"; in two places "earned income" (which, as we have seen, is not unambiguous) was used in lieu of "net profit," and in many no changes were made and the use of

[23] Such deduction would have violated the original purpose of the disallowance-of-deductions provision. *See* note 12 *supra*.

[24] The changes made in the instruction comprised the addition of a sentence parroting the statutory phrase on the earned income of a shareholder-employee of a corporation, the reduction of the listing of items that are not earned income from boldface capitals to regular type, and the separation of the former one paragraph instruction into two paragraphs.

[25] This heading was not changed.

"net profits" continued. Thus, the minor alterations in 1969, if noticeable, were unclear and ambiguous at best. The Service certainly did not call taxpayers' attention to or clearly explain the changes, which therefore were inadequate to effect a turn-about in the long-standing interpretation which had prevailed until that time.

We are left, then, with Revenue Ruling 75–86, 1975–1 CUM. BULL. 242, as the only clear and pertinent administrative adoption of the interpretation the Government presses here.[26] This ruling, however, was issued only after this litigation began, does not state that it is to be retroactive, conflicts with the interpretation in effect during the tax years involved in this suit, and adversely affects this taxpayer. Whatever its prospective effect may be—an issue we are not called upon to decide—Revenue Ruling 75–86 cannot be applied retroactively to the plaintiff's 1969 and 1970 tax years. *See Crespo* v. *United States*, 185 Ct. Cl. 127, 399 F. 2d 191 (1968); *American Potash & Chem. Corp.* v. *United States*, 185 Ct. Cl. 161,

[26] One provision of the regulations appears to add some partial weight to the Government's view; section 1.911–2(c)(2) stipulates that "[t]he entire amount received as professional fees shall be treated as earned income if the taxpayer is engaged in a professional occupation, such as a doctor or a lawyer, even though he employs assistants to perform part or all of the services, provided the patients or clients are those of the taxpayer and look to the taxpayer as the person responsible for the services performed." However, this limited regulation cannot be deemed clearly pertinent to this case. It does not mention the partnership situation, in which the partnership, not the taxpayer, receives the professional fees and is the "person" to which the clients look; and therefore it does not tell us that it is applicable to a partner or, if applicable, whether we should attribute to a partner a percentage of the partnership's professional fees or, instead, the fees paid by clients for whom the partner is assigned responsibility. Nor does it deal, even for the single professional, with expenses other than compensation to assistants and represents, at best, only a partial thrust toward a gross income interpretation. Upon analysis, the paragraph becomes another example of the failure of the Service to deal with partnerships in the section 911 regulations. In its application only to professionals, it also illustrates the discrimination that may result between various taxpayers performing similar services and receiving equal pay. *Cf.* note 3 *supra*. The regulation, in force while the Service was following a net profit interpretation in cases such as *Carey* v. *United States*, 192 Ct. Cl 536, 427 F. 2d 763 (1970) (involving, as this case does, a partner in an accounting firm) and in the tax forms and guides, is not enough, standing alone, to prevent the implementation in this suit of the net profit construction. *See* Treas. Reg. § 1.911–2(c)(2) (1963) (identical to Treas. Reg. § 1.911–1(a)(4) (1957)).

179, 399 F. 2d 194, 205, *on petition for reconsideration*, 185 Ct. Cl. 186, 402 F. 2d 1000 (1968).[27]

C

In conclusion, then, plaintiff has demonstrated that the long-standing administrative intepretation, manifested in many publications and actions, related a partner's earned income to his share of partnership net income. The Government has countered the plaintiff's analysis only with an interpretation reached many years after all significant legislative action had been completed (and after the tax years in issue) and with a suggestion that the Service had not focused on the issue prior to the taxable years. We can say with the Supreme Court in *Fribourg Navigation Co.* v. *Commissioner*, 383 U.S. 272, 280 (1966), that "[t]his is hardly a persuasive response to the overwhelmingly consistent display of his [the Commissioner's] position." The net income interpretation for partners, contemporaneous with the first statutory imposition of limits on the amount excludable and maintained for many years through changes in the statute, fixed the meaning of section 911 for this taxpayer during the years in suit, 1969 and 1970. *See NLRB* v. *Bell Aerospace Co.*, 416 U.S. 267, 274–75 (1974); *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969); *Fribourg Navigation Co.* v. *Commissioner*, *supra* at 279–86; *Udall* v. *Tallman*, 380 U.S. 1, 16–18 (1965); *United States* v. *Leslie Salt Co.*, 350 U.S. 383, 388–97 (1956). In the light of the ambiguity of section 911, that interpretation was clearly reasonable.

Plaintiff's motion for summary judgment is granted, defendant's motion is denied, and the case is remanded for further proceedings under Rule 131(c) to determine the amount of plaintiff's recovery, with any offset to which the defendant may be entitled taken into account.[28]

[27] The Government did not argue for retroactive application of this ruling; it cited the ruling only as the latest example of the pre-existing Service gross income interpretation, but we have determined that the pre-existing construction was to the contrary.

[28] Because we have ruled in favor of plaintiff, the offset issue raised by the Government must be tried.

Syllabus

MARGARET J. HENDRICKS v. THE UNITED STATES

No. 161–74

DORIS T. ACHESON, ET AL. v. THE UNITED STATES

No. 163–74

ELLEN J. LYMAN, ET AL. v. THE UNITED STATES

No. 164–74

[Decided June 16, 1976]

ON PLAINTIFFS' AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Civilian pay; Canal Zone employees; validity of regulations re tropical differential allowance.—Plaintiffs, married female employees of the Panama Canal Government or a Canal Zone office of a United States Government agency, seek to recover lost overseas tropical differential allowances accruing after January 9, 1971, claiming that the regulations promulgated in 1971 and 1974 are not in accord with the Canal Zone Code, constitute an abuse of discretion, discriminate against them on the basis of marital status and sex, and violate the declaration of congressional policy of equal pay for substantially equal work in the Federal service. It is *held* that the regulations are valid. The Secretary of the Army is not required to pay an allowance to plaintiffs based on 2 C.Z.C. § 146 providing for tropical differential allowance. The regulations do not constitute an abuse of discretion, they do not conflict with the provisions of said Sec. 146, Sec. 145 (uniform Canal Zone compensation rates) or Sec. 101 (compensation fixed by Governor). The regulations are not at odds with 5 U.S.C. § 7152 (rules and regulations may not discriminate), Sec. 7154 (Federal schedule pay rates may not discriminate) or Sec. 5301 (equal pay for equal work). Plaintiffs' motion for summary judgment is denied, defendant's cross-motion is granted and the petitions are dismissed.

Court of Claims jurisdiction; claims against the United States; employees of the Government; Canal Zone.

[1] Although plaintiffs' petition omits a jurisdictional statement and would appear to base jurisdiction on statutes which allegedly invalidate regulations relating to tropical differential compensation of United States citizen-employees of the United States working in

the Canal Zone if the regulations are invalidated plaintiffs must be paid the tropical differential and the instant suit becomes a pay suit under the Tucker Act, 28 U.S.C. § 1491 (1970).

Courts ⇐ 449(1)

Statutes; construction and operation; ordinary meaning of terms. [2] The unambiguous wording of a statute shall be given its plain and commonly understood meaning. Under 2 C.Z.C. § 142(b)(1) the Secretary of the Army (by delegation of power from the President) is unambiguously permitted to exclude any employee from the Canal Zone wage and employment practices provisions. Had Congress intended otherwise, it could have enacted the subsection to apply only to specifically designated individuals.

Armed Services ⇐ 27

Statutes ⇐ 188

Civilian pay; Canal Zone employees; regulations re tropical differential allowance; validity of regulations; statutory authority. [3] Where 2 C.Z.C. § 146 (1962) permits the head of the department concerned to pay tropical differential compensation to U.S. citizen-employees of the United States Government working in the Canal Zone in such amounts as he determines to be payable, and where the Secretary of the Army under 2 C.Z.C. § 142(b)(1) is permitted to exclude any employee or position from the tropical differential payments, regulations promulgated in 1971 and 1974 by the Secretary denying tropical differential compensation in certain designated employee categories are valid, constitute a valid exercise of discretion, and have a rational basis in excluding only those employees with respect to whom the incentive to recruit qualified personnel is unnecessary.

Armed Services ⇐ 27

Civilian pay; Canal Zone employees; wage and employment practices; basic compensation v. tropical differential allowance. [4] Statutes, regulations and treaties have consistently differentiated basic compensation (which must be applied uniformly under 2 C.Z.C. § 145) from the differential allowance. Compensation is payment for the rendering of services. The differential provided in Sec. 146 is an item separate and apart from basic compensation and is merely to encourage the presence of U.S. citizen-employees in the Canal Zone. There is no mandatory requirement for uniform application of the differential allowance despite the requirement of Sec. 145.

Armed Services ⇐ 27

Civilian pay; Canal Zone employees; wage and employment practices; basic compensation v. tropical differential allowance. [5] Since basic compensation is different from the tropical differential allowance, 2 C.Z.C. § 101 speaking in terms of compensation

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prescribed by the Governor "except as otherwise provided by law," does not conflict with the tropical differential provision of Sec. 146 or regulations permitting payment of the differential at the discretion of the Secretary of the Army. Assuming the Governor is required to pay the full differential to all employees, the Secretary's authority transcends the power of the Governor by virtue of 2 C.Z.C. § 31, requiring that the Governor be supervised by the President or his designated representative. Section 146 and the amended regulations assigning to the Secretary of the Army the Presidential duties to direct the wage and employment practices and permitting the Secretary to exclude employees from the compensation provisions of the Code, prevail notwithstanding Sec. 101. Sec. 101, like Sec. 146, is not cast in mandatory terms.

Armed Services ⇐ 27

Civilian pay; Canal Zone employees; regulations re tropical differential allowance; discrimination.

[6] Since the tropical differential regulations promulgated in 1971 and 1974 by the Secretary of the Army are calculated to exclude those U.S. citizen-employees for whom no Canal Zone employment incentive is necessary, the regulations represent a proper and rational exercise of discretion, have an important administrative purpose, and do not violate the proscriptions of 5 U.S.C. § 7152 (Supp. III, 1973) designed to prevent discrimination in Federal employment based on marital status or sex.

Armed Services ⇐ 27

Civilian pay; Canal Zone employees; regulations re tropical differential allowance; discrimination.

[7] 5 U.S.C. § 7154(b) (1970) designed to prevent discrimination based on sex or marital status in setting general schedule pay rates, does not invalidate the tropical differential regulations promulgated in 1971 and 1974, since the general schedule pay rates deal solely with *compensation* for services rendered and are separate and apart from the tropical differential *allowance* calculated to exclude only those employees with respect to whom the incentive to recruit qualified personnel is unnecessary.

Armed Services ⇐ 27

Civilian pay; Canal Zone employees; regulations re tropical differential allowance; equal pay for equal work.

[8] Since 5 U.S.C. § 5301 (1970) applies only to *compensation* for services rendered, it does not invalidate the 1971 and 1974 tropical differential *allowance* regulations excluding only those U.S. citizen-employees for whom no Canal Zone employment incentive is necessary.

Armed Services ⇐ 27

Thomas M. Gittings, Jr., attorney of record for plaintiffs. *Albert J. Joyce, Jr.* and *Joe A. Shull*, of counsel.

Thomas W. Petersen, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *David A. Shaw*, of counsel.

Before SKELTON, KASHIWA, and KUNZIG, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

In these consolidated civilian pay cases, plaintiffs, married female employees of the Panama Canal Government or a Canal Zone office of a United States Government agency, claim they have been deprived by regulation of what is known as an overseas tropical differential allowance. Because the regulations correctly deny plaintiffs' entitlement to the tropical differential and because we find no abuse of discretion, we hold for defendant.

Plaintiffs' attack on the denial of the tropical differential requires scrutiny of the statutory underpinnings of the Canal Zone Government and its wage and employment practices.

In 1912, Congress established a government for the Canal Zone and authorized the President to appoint a governor. Act of Aug. 24, 1912, 37 Stat. 560, 561. Congress also empowered the President to fix compensation of Canal Zone Government employees in an amount not to exceed by more than 25 percent that paid to persons employed by the U.S. Government in the continental United States for the same or similar services. *See* 2 Canal Zone Code (2 C.Z.C.) § 81(c) (1934).[1] President Wilson exercised this authority. Exec. Order No. 1888, 7 Pan. Can. Rec. 228 (Feb. 2, 1914).

All U.S. citizens employed in the Canal Zone originally received a tropical differential of 25 percent of their base salary. This practice began in 1914 and continued until 1964. Meanwhile, in 1955, the U.S. and Panama entered into a treaty which granted qualified Panamanian citizens the right

[1] This power is now placed in the hands of the Governor and the heads of executive departments. 2 C.Z.C. §§ 101, 144, 76A Stat. 14–15, 17 (1962).

The current codification of the Canal Zone Code is found in 76A Stat. Per 1 C.Z.C. § 1(b) (1962), we shall hereinafter cite such codification by use of the Canal Zone Code equivalents.

to equal employment opportunity in U.S. Canal Zone offices. The treaty provided that the same *basic wages* would be paid to Panamanians as paid to U.S. citizen-employees. However, the agreement permitted U.S. citizens to receive a tropical differential allowance *in addition to their base pay*. Memorandum of Understandings to Treaty of Jan. 25, 1955, implemented by Act of July 25, 1958, 72 Stat. 405, *et seq.*

Congress had also empowered the President to delegate his Canal Zone administrative powers. This legislation (codified as 2 C.Z.C. § 155 (1962)) provides:

> The President may delegate any authority vested in him by this subchapter [governing Canal Zone administration], and may provide for the redelegation of any such authority. [2 C.Z.C. § 155(b) (1962)].

Initially, the President delegated his Canal Zone authority to the Secretary of War. Exec. Order No. 9746, 3 C.F.R. 148 (Supp. 1946). Later, President Eisenhower redelegated it to the Secretary of the Army. Exec. Order No. 10595, 3 C.F.R. 58 (Supp. 1955). Finally, in 1958, the President assigned to the Secretary of the Army the Presidential duties to direct the wage and employment practices of the Canal Zone Government (2 C.Z.C. § 142 (1962))[2] and to coordinate the departments engaged in Canal Zone activities by issuing regulations (2 C.Z.C. § 155(a) (1962)).[3] Exec. Order No. 10794, 3 C.F.R. 76–77 (Supp. 1958). In 1964, the President supplemented Exec. Order No. 10794 by, among other items, per-

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[2] 2 C.Z.C. § 142 (1962) provides in part:

"§ 142. *General rules governing wage and employment practices.*

"(a) The head of each department shall conduct the wage and employment practices in the Canal Zone of his department in accordance with the:

"(1) principles established in item 1 of the Memorandum of Understandings set forth in section 1(b) of [72 Stat. 405] * * *;

"(2) provisions of this subchapter;

"(3) regulations promulgated by, or under the authority of, the President * * *;

"(4) provisions of applicable law.

"(b) To the extent he deems appropriate, the President may:

"(1) exclude any employee or position from this subchapter or from any provision of this subchapter; * * *." [2 C.Z.C. § 142 (1962)].

[3] 2 C.Z.C. § 155(a) (1962) provides:

"The President shall coordinate the policies and activities of the respective departments under this subchapter, and may promulgate regulations necessary and appropriate to carry out the provisions and accomplish the purposes of this subchapter." [2 C.Z.C. § 155(a) (1962)].

mitting the Secretary of the Army *to exclude* employees from the compensation provisions of the Canal Zone Code (a power now given to the President by 2 C.Z.C. § 142(b)(1) (1962), *see* note 2, *supra*). Exec. Order No. 11171, 3 C.F.R. 468 (1965).[4]

Pursuant to the statutes and Executive Orders, the Secretary of the Army issued various regulations. *See* 5 C.F.R. § 1201 (1964), now 35 C.F.R. § 253 (1975). One of the provisions reduced the tropical differential (previously set at 25 percent for all employees) to 15 percent for some employees and eliminated it altogether for others. 5 C.F.R. § 1204.12 (Supp. 1966).

This action was immediately questioned. *Hendricks* v. *United States*, Ct. Cl. No. 202–68 (filed July 15, 1968). Claimants attacked the 1964 regulations and sought recovery of lost differential pay originating with its denial in October 1966. The parties settled the prior action by agreement on May 7, 1971.[5]

Perhaps spurred in part by that case, in 1971 the Secretary of the Army altered the Canal Zone regulations covering the tropical differential. The 1971 amendments provided in part:

> § 253.135. *Tropical differential.*
>
> * * * * *
>
> (b) The tropical differential shall be paid to employees who are U.S. citizens except as provided in the following subparagraphs:
>
> (1) When a U.S. citizen employee is married to another U.S. citizen employee, the differential may be paid to one spouse only.
>
> (2) When a U.S. citizen employee is married to a person not employed by a department such employee is

[4] Exec. Order No. 11171 provides in part:

"Subject to the further provisions of this order, there is delegated to the Secretary of the Army the authority vested in the President * * *

"(1) To exclude any employee or position from any or all provisions of [the Canal Zone Code Wage and Employment Practices statutes] * * *" [Exec. Order No. 11171, § 2(a)(1), 3 C.F.R. 468 (1965)].

[5] The prior suit has no impact on the present controversy as the instant action seeks recovery for lost differential allowances accruing after Jan. 9, 1971. The settlement agreement specifically provided that it was made without prejudice to claimants' right to recover additional amounts for periods subsequent to Jan. 9, 1971.

eligible to receive the differential only if such employee is the member of the family whose job may reasonably be deemed to be the job which determines the location of the family in the area. The spouse of a person serving in the U.S. military forces in the area shall not be deemed to be a person whose job determines such location.

(3) A child or stepchild of a resident of the Canal Zone or the Republic of Panama who is under 21 years of age and unmarried is not eligible.

[35 Fed. Reg. 19750–51 (1970) (effective Jan. 10, 1971)].

On April 28, 1974, further amendments to the tropical differential regulations became effective. 35 C.F.R. § 253.135(b)(2) was altered to provide:

> The U.S. citizen employee whose spouse is a member of a U.S. military service stationed in the area may be paid the differential only to the extent that the amount of the differential otherwise payable exceeds the amount of the total housing allowance (BAQ plus the housing portion of the station allowance) established for Panama City, Republic of Panama for a military member having the same rank and family size as the employee's military spouse. The U.S. citizen employee whose spouse, by reason of U.S. Government employment in the Republic of Panama, is eligible under the Department of State Standardized Regulations (Government Civilians, Foreign Areas) (DSSR) for a living quarters allowance (LQA) may be paid the differential only to the extent the amount of the differential otherwise payable exceeds the amount of LQA established for Panama City, Republic of Panama by sections 920 and 932.22 of the DSSR for one in the same quarters group and with the same family size as the employee's spouse. [39 Fed. Reg. 13650–51 (1974)].

Plaintiffs in the instant action contend that they have been illegally denied tropical differential allowances by the Secretary of the Army's promulgation of these amendments. Plaintiffs say that the altered tropical differential regulations are void. They believe they should receive lost differential pay based on prior practice of granting the full 25 percent differential to all U.S. citizens employed by the Canal Zone Government.

We determine that the 1971 and 1974 amendments to the tropical differential regulations are valid. The Secretary of

the Army correctly denied the allowance to certain employees, including plaintiffs. Therefore, we hold for defendant.

Plaintiffs mount a six-tiered attack on the 1971 and 1974 amendments to the tropical differential regulations, arguing that they are at odds with various statutes.[6] Plaintiffs contend that the amendments conflict with: (1) 2 C.Z.C. § 146 (1962)[7] which grants entitlement to the tropical differential allowance; (2) 2 C.Z.C. § 145 (1962)[8] calling for uniform application of Canal Zone pay rates; (3) 2 C.Z.C. § 101 (1962)[9] granting power to the Governor to appoint Canal Zone employees and fix compensation; (4) 5 U.S.C. § 7152 (Supp. III, 1973)[10] empowering the President to promulgate rules to forbid discrimination based on marital status in Federal employment and proscribing Federal employment benefits discriminating on the basis of sex or marital status; (5) 5 U.S.C. § 7154 (1970)[11] prohibiting discrimination in establishment of General Schedule Pay rates based on sex or marital status; and (6) 5 U.S.C. § 5301 (1970) setting forth the general Federal philosophy of equal pay for equal work.[12]

None of these statutes are of help to plaintiffs.

(1) *2 C.Z.C. § 146 (Tropical Differential):*

Plaintiffs' main attack on the Secretary of the Army's amendments denying them tropical differential allowance is based on 2 C.Z.C. § 146 (1962). This statute provides in part:

> § 146. *Additional allowance and differential.*
>
> In addition to established basic compensation, there shall be paid to each employee who is a citizen of the

[6] Plaintiffs' petition omits a jurisdictional statement. A cursory reading of the claim would appear to reveal that plaintiffs would base jurisdiction on the statutes which allegedly invalidate the regulations. However, a closer analysis makes it clear that plaintiffs in fact sue for pay under the Tucker Act, 28 U.S.C. § 1491 (1970). In other words, if plaintiffs can successfully attack the amended regulations, *they must be paid the tropical differential,* and the current action becomes a classic pay suit under the Tucker Act.

[7] The applicable language of section 146 is contained in Part (1), *infra.*

[8] *See* Part (2), *infra,* for full text of section 145.

[9] *See* Part (3), *infra.*

[10] *See* Part (4), *infra.*

[11] *See* Part (5), *infra.*

[12] *See* Part (6), *infra.*

United States such amounts as the head of the department concerned determines to be payable, as follows:

* * * * *

(2) an overseas (tropical) differential not in excess of an amount equal to 25 percent of the aggregate amount of the rate of basic compensation so established and the amount of the allowance provided in accordance with paragraph (1) of this section. [2 C.Z.C. § 146(2) (1962)].

Plaintiffs contend that the altered regulations are void because they conflict with section 146. According to plaintiffs, section 146 *mandates* payment of the tropical differential and the Secretary of the Army's refusal to pay is illegal. For several reasons there is no conflict between the statute and the regulations. The action of the Secretary denying the differential to plaintiffs, is correct.

Plaintiffs' section 146 argument is based upon an erroneous interpretation of the statute. Plaintiffs emphasize the portion of the codification which provides that the differential "shall be paid." From this plaintiffs attempt to have the court find the payment mandatory. However, plaintiffs conveniently ignore the remainder of section 146 which calls for payment of the tropical differential in "such amounts *as the head of the department concerned determines to be payable.*" Given this, section 146 is not mandatory as plaintiffs would urge, but is *discretionary.* In short, the Secretary of the Army's tropical differential amendments represent an exercise of discretion in excluding plaintiffs.

Moreover, under 2 C.Z.C. § 142(b)(1) (*see* note 2, *supra*) the Secretary of the Army (by delegation of power from the President in Exec. Order No. 11171, *supra*) has the authority to "exclude any employee or position from this subchapter [governing Canal Zone employment practices]." Taken at face value, this statute grants ample authority to the Secretary to exclude plaintiffs from the tropical differential payments. Plaintiffs make much of a statement by Congressman Hemphill purporting to clarify section 142(b)(1). This discussion represents an attempt to restrict the President's power to exclude positions to "the Governor of the Canal

Zone, the Deputy Governor, the President of the Panama Canal, and other similar officials." 104 Cong. Rec. 11,387 (1962). However, absent further evidence of Congressional desire to so limit subsection 142(b)(1), the clear wording of the statute is sufficient evidence that Congress did not intend this legislation to be so limited. "The unambiguous wording of a statute shall be given its plain and commonly understood meaning." *Sharples* v. *United States*, 209 Ct. Cl. 509, 516, 533 F. 2d 550, 553 (1976); *Selman* v. *United States*, 204 Ct. Cl. 675, 680, 498 F. 2d 1354, 1356 (1974). If Congress had enacted subsection 142(b)(1) to apply as narrowly as believed by Congressman Hemphill, it could have so provided. The statute unambiguously permits the Secretary to exclude *any employee* from the Canal Zone wage and employment practices provisions. As stated by the Fifth Circuit Court of Appeals in *Leber* v. *Canal Zone Central Labor Union*, 383 F. 2d 110 (5th Cir. 1967), *cert. denied sub nom. Bramlett* v. *Leber*, 389 U.S. 1046 (1968):

> A reading of all parts of the subchapter and an understanding of the purpose of the [tropical] differential lead us to conclude that the Secretary could make reasonable exclusions of United States citizens from the benefits of the differential. [*Id.* at 119].

We agree with the court's reasoning in *Leber*. The Secretary of the Army under 2 C.Z.C. § 142(b)(1) has authority to exclude plaintiffs from the benefits of the tropical differential allowance.

Finally, although plaintiffs fail expressly to argue otherwise, it is clear that the amended regulations do not constitute an abuse of discretion. We could not find the regulations valid if the Secretary had arbitrarily excluded certain individuals. However, the amended regulations have a rational basis or purpose. They constitute a valid exercise of discretion. As stated by the court in *Port Authority* v. *United States*, 193 Ct. Cl. 108, 432 F. 2d 455 (1970) (relying on *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965)):

> Where administrative control has been authorized by Congress, the judicial function is exhausted when there is found to be a rational basis for the conclusions ap-

proved by the administrative body. *Mississippi Valley Barge Line Co.* v. *United States*, 292 U.S. 282, 286–87 * * * (1934). [*Port Authority*, *supra*, 193 Ct. Cl. at 120, 432 F. 2d at 461].

The amendments which plaintiffs attack seek to provide a tropical differential "incentive" to encourage U.S. citizens to work in the Canal Zone. The regulations now exclude those U.S. citizens who would not reasonably demand additional inducement to pursue employment in the Canal Zone. As found by the court in *Leber*, *supra*:

> The purpose of the differential is admitted to be an *inducement* to get American citizens to work overseas in so-called hardship areas and to alleviate some of the financial burdens of taking such employment. * * * [*Id.* at 120 (emphasis added)].

The 1971 regulations emphasize this purpose in the provisions allowing for periodic review and adjustment:

> [T]o the extent necessary to furnish a suitable *incentive* in recruitment of qualified personnel and to provide pay benefits substantially equal to those accorded U.S. citizens employed by the Federal Government in comparable foreign areas. [35 C.F.R. § 253.135(a) (1975)].

So long as the Secretary's regulations are rationally calculated to exclude only those employees for whom the incentive is unnecessary, we cannot say that they constitute an abuse of discretion. A careful scrutiny of the exclusions demonstrates that the regulations are properly drawn.

The 1971 amendments exclude four categories of employees. First, those whose spouse is also a Government employee and who is the family member who has elected to receive the differential. Second, those employees whose presence in the Canal Zone is attributable to the job of his or her spouse. Third, an employee whose spouse serves in the military and receives rent-free quarters or quarters allowance. Fourth, an employee who is under 21, unmarried and the child or stepchild of a resident of the Canal Zone or the Republic of Panama. Such a person would usually not maintain a separate household. Significantly, each of these categories provides an example of a situation where the excluded

employee would have little need for inducement to work in the Canal Zone.

The 1974 alterations also emphasize the reasonableness of the Secretary's decision. The Secretary deleted the second category of exclusions because it proved too difficult to administer and relaxed the third category to allow a partial differential where it exceeded the quarters allowance of a spouse because it might be necessary to lure some families into the Canal Zone.

Rather than constituting arbitrary exclusions, the regulations quite rationally deny the allowance for U.S. citizen-employees in cases where no incentive is required.

The amended regulations do not conflict with 2 C.Z.C. § 146. Section 146 grants discretion to the Secretary of the Army to decide whether or not payment of the allowance is necessary. Section 142(b)(1) further permits the Secretary to exclude employees from the Canal Zone Code employment provisions. Such discretion has not been abused in the amendments to 35 C.F.R. § 235.135(b). Therefore, plaintiffs cannot prevail on their argument that the differential is required by 2 C.Z.C. § 146.

(2) *2 C.Z.C. § 145 (Uniform Canal Zone Compensation Rates):*

Plaintiffs further argue that the amended regulations are invalid because they create an impermissible disparity in compensation rates. 2 C.Z.C. §§ 144–45 (1962) compel uniform application of basic compensation rates.

> § 144. *Compensation.*
>
> (a) The head of each department, in accordance with this subchapter, shall establish, and from time to time may revise, the rates of basic compensation for positions and employees under his jurisdiction. [2 C.Z.C. § 144(a) (1962)].
>
> § 145. *Uniform application of standards and rates.*
>
> The established employment standards and rates of basic compensation established pursuant to sections 143

> and 144 of this title shall be applied uniformly, irrespective of whether the employee or individual concerned is a citizen of the United States or a citizen of the Republic of Panama. [2 C.Z.C. § 145 (1962)].

Plaintiffs contend that the amendments create a disparity of pay rates in violation of section 145 and are thereby invalid. Again, plaintiffs misconstrue the Canal Zone Code. There is no conflict between the amended regulations and the statutes.

Statutes, regulations, and treaties have consistently differentiated *basic compensation* (which must be uniform per section 145) from the *differential allowance*. Compensation is payment for the rendering of services. The allowance is merely to encourage the presence of U.S. citizen-employees in the Canal Zone. To this end, section 146, *supra*, contains the following phraseology: "In addition to established basic compensation, there shall be paid * * * an overseas (tropical) differential * * *" 2 C.Z.C. § 146(2) (1962). Further, 2 C.Z.C. § 148 (1962) recognizes the same distinction in providing for the method of computation of benefits based on compensation (such as insurance, disability and overtime):

> [For purposes of computing benefits based on salary] [t]he basic compensation of each employee * * * shall include the rate of *basic compensation* established for his position, *and the amount of the allowance and differential* determined, in the manner respectively provided by sections 144 and 146 [the tropical differential] of this title. [2 C.Z.C. § 148(6) (1962)].

To the same effect, see the provisions of the 1955 U.S.-Panama treaty discussed above. 72 Stat. 405, *et seq.*

The tropical differential allowance is an item separate and apart from basic compensation. Accordingly, there is no mandatory requirement for uniform application of the allowance despite the fact that basic compensation must be equal as required in section 145. In short, the amended regulations are not void measured against sections 144-45 of the Canal Zone Code.

(3) *2 C.Z.C. § 101 (Governor Fixes Compensation):*

The third Canal Zone Code section relied upon by plaintiffs is 2 C.Z.C. § 101 (1962). Section 101 provides:

> § 101. *Appointment and compensation of Government employees.*
>
> (a) Except as otherwise provided by law, and subject to the supervision provided by section 31 of this title, the Governor shall:
>
> "(1) appoint all officers and employees of the Canal Zone Government; and
>
> "(2) prescribe the compensation of officers and employees of the Canal Zone Government, and establish their conditions of employment. * * *"
>
> (b) Compensation prescribed by the Governor under this section may not exceed, in any case, by more than 25 percent, the compensation paid for the same or similar services to persons employed by the Government in the continental United States. * * * [2 C.Z.C. § 101 (1962)].

Plaintiffs would say *the Governor* under section 101 must prescribe the compensation, *i.e.*, not the Secretary of the Army. This section, like the ones already discussed, is of no help to plaintiffs.

Section 101 speaks in terms of compensation. Compensation is different from the tropical differential allowance. *See* Part (2), *supra*. If, as plaintiffs allege, section 101 is mandatory, it does not conflict with the tropical differential statute or regulations which allow for payment of the differential within the discretion of the Secretary of the Army. *See* Part (1), *supra*.

Moreover, section 101 clearly states that it applies "*except as otherwise provided by law.*" If there is a conflict between section 101 and section 146 (under which the allowance has been excluded), the latter statute would prevail. Section 146 is discretionary. Again, plaintiffs may not win based on use of section 101.

In addition, section 101 states that it applies "subject to the supervision provided by section 31." Section 31 requires

that the Governor be supervised by the President or his designated representative (now the Secretary of the Army, *see* Exec. Order No. 10595 *supra*):

> § 31. *Canal Zone Government; administration and functions generally.*
>
> The Canal Zone Government, an independent agency of the United States, shall:
>
> (1) be administered, under the supervision of the President or such officer of the United States as may be designated by him, by a Governor of the Canal Zone. * * * [2 C.Z.C. § 31 (1962)].

Even if the Governor is required to pay the full differential to all employees, the Secretary of the Army's authority transcends the power of the Governor. If there is a conflict between the powers of the Governor and those of the Secretary of the Army, those of the latter are paramount and the amended regulations under attack are valid, notwithstanding section 101.

Finally, the major premise of plaintiffs' section 101 argument (that the Governor *must* pay the full differential to all employees) is also erroneous. Section 101, like section 146, is not cast in mandatory terms. The authority of the Governor to set pay rates is discretionary within the 25 percent limit and not mandatory. Again, plaintiffs fail to carry their argument that the differential payment is mandatory.

In short, the amendments to the tropical differential regulations excluding plaintiffs are not overcome by section 101 of the Canal Zone Code.

(4) *5 U.S.C. § 7152 (Rules and Regulations May Not Discriminate):*

Plaintiffs further attack the amendments to the tropical differential regulations as invalid in light of 5 U.S.C. § 7152 (Supp. III, 1973), *amending* 5 U.S.C. § 7152 (1970).[13] This

[13] The balance of plaintiffs' arguments are based on 5 U.S.C. Plaintiffs urge that we apply the protections of this title to their employment in the Canal Zone. They recognize that they are covered by the Canal Zone Merit System

statute allows the President to issue rules preventing discrimination in Federal employment based on marital status. It also prevents implementation of regulations which sexually discriminate between married males and married females.

> § 7152. *Marital status.*
>
> (a) The President may prescribe rules which shall prohibit, as nearly as conditions of good administration warrant, discrimination because of marital status in an Executive agency or in the competitive service.
>
> (b) Regulations prescribed under any provision of this title, or under any other provision of law, granting benefits to employees, shall provide the same benefits for a married female employee and her spouse and children as are provided for a married male employee and his spouse and children. * * * [5 U.S.C. § 7152 (Supp. III, 1973)].

The amendments to the tropical differential regulations do not violate the proscriptions of this regulation.[14]

The amended regulations are not at odds with subsection 7152(a). In this subsection the President is given the authority to promulgate rules to prevent marital discrimination. Plaintiffs fail to cite any such rules which would invalidate the amended tropical differential regulations. Moreover, discrimination based upon maritial status is to be proscribed "as nearly as conditions of good administration warrant." As we have seen in Part (1), *supra*, the amendments are

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rather than the U.S. Government Merit System, but would apply the provisions of 2 C.Z.C. § 149(c)(1) (1962) to obtain the same benefits.

Subsection 149(c)(1) provides that "[t]he Canal Zone Merit System shall * * * conform generally to policies, principles, and standards established by or in accordance with the [U.S. Government] Civil Service Act. * * *"

We need not decide whether plaintiffs are entitled to the benefits of 5 U.S.C. at this juncture. Even if title five applies to plaintiffs' situation, plaintiffs are unable to prevail on the merits of their discrimination arguments. Therefore, we do not decide the question at this time.

[14] Defendant argues that plaintiffs cannot maintain their discrimination claims, either because they have failed to exhaust administrative remedies, *Pettit* v. *United States*, 203 Ct. Cl. 207, 488 F. 2d 1026 (1973), overruled on other grounds, *United States* v. *Testan*, 424 U.S. 392 (1976), or because all questions concerning discrimination in Federal employment are matters exclusively within the jurisdiction of the district courts, *Brown* v. *General Services Administration*, 507 F.2d 1300, 1306–07 (2d Cir. 1974), *cert. granted*, 421 U.S. 987 (1975). Again, we need not decide such questions as plaintiffs fail to prevail on the merits of the instant action.

calculated to exclude those U.S. citizens for whom no Canal Zone employment incentive is necessary. As such, not only do the regulations represent a proper and rational exercise of discretion, but they also have an important administrative purpose. Accordingly, the amended regulations are not invalid in comparison with 5 U.S.C. § 7152(a).

Nor do they conflict with subsection 7152(b). This portion of the statute prevents sex discrimination between married males and married females in the granting of Federal employment benefits. Significantly, the tropical differential regulations discriminate not on the basis of sex, but on the basis of age and marital status.[15] Again, the amended regulations do not violate subsection 7152(b).

(5) *5 U.S.C. § 7154 (General Schedule Pay Rates May Not Discriminate):*

Plaintiffs also argue that the amended regulations offend the provisions of 5 U.S.C. § 7154 (1970). This statute is designed to prevent discrimination based on sex or marital status in setting the *General Schedule Pay Rates:*

> § 7154. *Other prohibitions.*
>
> * * * * *
>
> (b) In the administration of * * * subchapter III of chapter 53 * * * of this title [fixing General Schedule Pay Rates], discrimination because of race, color, creed, sex or marital status is prohibited with respect to an individual or a position held by an individual. [5 U.S.C. § 7154(b) (1970)].

However, subsection 7154(b) does not invalidate the tropical differential amendments. Once again, plaintiffs attempt to confuse the payment of compensation with the incentive nature of the differential allowance. Subsection 7154(b) prohibits discrimination in the General Schedule Pay Rates. The General Schedule Pay Rates deal solely with *compensation* for services rendered. It is separate and apart from the trop-

[15] As evidence of the fact that the amendments do not discriminate between married males and females, we note that the same regulations are currently under attack in the district court by three male employees of the Panama Canal Co. *Garcia* v. *Calloway*, D.C.C. Civ. No. 74-779 (Filed May 22, 1974).

ical differential *allowance*. *See* Part (2), *supra*. Plaintiffs cannot use subsection 7154(b) to invalidate the Secretary's regulations.

(6) *5 U.S.C. § 5301 (Equal Pay for Equal Work):*

Finally, plaintiffs suggest that the amended regulations violate the provisions of 5 U.S.C. § 5301(1970):

> § 5301. *Policy.*
>
> (a) It is the policy of Congress that Federal pay fixing for employees under statutory pay systems be based on the principles that—
>
> (1) there be equal pay for substantially equal work; * * *. [5 U.S.C. § 5301(a)(1) (1970)].

Section 5301 obviously applies only to *compensation*. We take no issue with the laudible general policy underlying Federal employment compensation. However, for the same reasons that other statutes cited by plaintiffs based on *compensation* do not invalidate the regulations pertaining to the tropical differential *allowance*, neither does section 5301. *See* Parts (2), (3) and (5), *supra*. Subsection 5301(a)(1) casts no aspersions on the Secretary of the Army's tropical differential regulations.[16]

In summary, the regulations promulgated by the Secretary of the Army excluding plaintiffs from the ambit of the tropical differential allowance, are valid. The Secretary is not required to pay an allowance to plaintiffs based on the provisions of 2 C.Z.C. § 146 (Tropical Differential). Nor did the regulations constitute an abuse of discretion. The regulations do not conflict with the provisions of 2 C.Z.C. § 146 (Tropical Differential), § 145 (Uniform Canal Zone Compensation Rates) or § 101 (Governor Fixes Compensation).

[16] The concurrence's use of *United States* v. *Testan*, 424 U.S. 392 (1976) to deny the 5 U.S.C. claims, mistakes the thrust of plaintiffs' position. We agree that if plaintiffs' action attempts to recover based solely on the discrimination statutes plaintiffs fail to state a claim for money damages. In such case *Testan* would apply. However, there is an "insulating factor" in this action which was not present in *Testan*. Plaintiffs do not attempt to recover a money damage claim on their 5 U.S.C. arguments, but attempt by use of these statutes, to have the Secretary's regulations declared invalid. Once the regulations are invalidated plaintiffs must be paid the full 25 percent tropical differential under the prior law and the Tucker Act. *Testan* simply does not apply in the case at bar.

Nor are they at odds with 5 U.S.C. § 7152 (Rules and Regulations May Not Discriminate), § 7154 (General Schedule Pay Rates May Not Discriminate) or § 5301 (Equal Pay for Equal Work). Therefore, plaintiffs have been unable to establish a right to receive the differential and defendant must prevail.

Accordingly, for the reasons stated above, plaintiffs' motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted and the petitions are dismissed.

SKELTON, *Judge*, concurring:

Although I concur in the result reached by the majority, I do not agree with all of the reasoning in the majority opinion. Furthermore, I believe there are issues and principles of law not included in the majority opinion that should be discussed and disposed of. Accordingly, I submit the following concurring opinion.

In these three consolidated cases, plaintiff, Margaret J. Hendricks and 140 other named plaintiffs, are married women who were either employees on January 10, 1971, or thereafter, up to the date of the filing of their petitions, of the Panama Canal Government, or of the Canal Zone office of an agency of the United States Government. They claim that they have been deprived by regulations issued by the Secretary of the Army in 1971 and 1974 of what is known as an overseas tropical allowance differential which they contend should have been paid to them in addition to their basic compensation. They sue here for the amount alleged to be due each of them, respectively, as such tropical differential allowance during the time each of them, respectively, was such employee between January 10, 1971, and the date of the filing of their petitions, and up to the date of judgment in this case.

The facts show that under the provisions of the Act of August 24, 1912, ch. 390, 37 Stat. 560, 561, Congress established a government for the Canal Zone and authorized the President to appoint the governor, and as supplemented by Executive Order 1888 of February 2, 1914, authorized the

President to fix the compensation of employees of the Canal Zone Government in such amount as not to exceed by more than 25 percent the compensation paid for the same or similar services to persons employed by the Government in the continental United States. *See* 2 C.Z.C. § 81(c) (1934 Ed.) for a verbatim codification.

On January 25, 1955, the Government of the United States and the Republic of Panama entered into a treaty of mutual understanding and cooperation which granted Panamanian citizens equality of opportunity for employment in all United States Government offices in the Canal Zone for which they were qualified, and provided for the payment to them of the same basic wages paid to United States citizen employees. It was provided in such agreement that there could be added to the base pay of a United States citizen employee an amount representing a tropical differential allowance.

Thereafter, on February 7, 1955, the President, by Executive Order 10595, designated the Secretary of the Army to supervise the administration of the Canal Zone Government by the Governor of the Canal Zone and to exercise the powers vested in the President by 2 C.Z.C. § 81 (1934 Ed.).

On July 25, 1958, Congress enacted 72 Stat. 405, *et seq.*, now codified as Subchapter III of ch. 7 of Title 2 C.Z.C. (1962) Ed.), 76A Stat. 6 *et seq.*, with respect to the Government of the Canal Zone and governing the wage and employment practices of the United States Government in the Canal Zone. This is the statute presently in force. It provided in pertinent part as follows:

> 2 C.Z.C. § 31. *Canal Zone Government; administration and functions generally.*
>
> The Canal Zone Government, an independent agency of the United States, shall:
>
> (1) be administered, under the supervision of the President or such officer of the United States as may be designated by him, by a Governor of the Canal Zone; * * * 76A Stat. 7.
>
> 2 C.Z.C. § 32. *Appointment and term of Governor.*
>
> The President, by and with the advice and consent of the Senate, shall appoint the Governor of the Canal

Zone. The Governor shall hold office for a term of four years and until his successor is appointed and has qualified. 76A Stat. 7.

2 C.Z.C. § 33. *General powers and duties of Governor.*

The Governor of the Canal Zone shall:

(1) have official control and jurisdiction over the Canal Zone; and

(2) perform all duties in connection with the civil government of the Canal Zone, which is to be held, treated and governed as an adjunct of the Canal. 76A Stat. 7.

* * * * *

2 C.Z.C. § 101. *Appointment and compensation of Government employees.*

(a) Except as otherwise provided by law, and subject to the supervision provided by section 31 of this title, the Governor shall:

(1) appoint all officers and employees of the Canal Zone Government; and

(2) prescribe the compensation of officers and employees of the Canal Zone Government, and establish their conditions of employment, including matters relating to transportation, medical care, leave, office hours, and hours of labor.

(b) Compensation prescribed by the Governor under this section may not exceed, in any case, by more than 25 percent, the compensation paid for the same or similar services to persons employed by the Government in the continental United States. The definition of "continental United States" contained in section 141 of this title applies to that term as used in this subsection. 76A Stat. 14.

The wage and employment practices are governed by the following:

2 C.Z.C. § 142. *General rules governing wage and employment practices.*

(a) The head of each department shall conduct the wage and employment practices in the Canal Zone of his department in accordance with the:

(1) principles established in item 1 of the Memorandum of Understandings set forth in section 1(b) of Public Law 85–550 (July 25, 1958, 72 Stat. 405);

(2) provisions of this subchapter;

(3) regulations promulgated by, or under the authority of, the President of the United States in accordance with this subchapter; and

(4) provisions of applicable law.

(b) To the extent he deems appropriate, the President may:

(1) exclude any employee or position from this subchapter or from any provision of this subchapter; * * *. 76A Stat. 16.

* * * * *

2 C.Z.C. § 144. *Compensation.*

(a) The head of each department, in accordance with this subchapter, shall establish, and from time to time may revise, the rates of basic compensation for positions and employees under his jurisdiction.

(b) The rates of basic compensation may be established and revised in relation to the rates of compensation for the same or similar work performed in the continental United States or in such areas outside the continental United States as may be designated in the regulations referred to in section 155(a) of this title.

(c) The head of each department may grant increases in rates of basic compensation in amounts not to exceed the amounts of the increases granted, from time to time, by Act of Congress in corresponding rates of compensation in the appropriate schedule or scale of pay. The head of the department concerned may make the increases effective as of such date as he designates but not earlier than the effective date of the corresponding increases provided by the Act of Congress.

(d) A rate of basic compensation established under this section may not exceed by more than 25 percent, when increased by the amounts of the allowance and the differential authorized by section 146 of this title, the rate of basic compensation for the same or similar work performed in the continental United States by employees of the Government of the United States. 76A Stat. 17.

2 C.Z.C. § 145. *Uniform application of standards and rates.*

The established employment standards and rates of basic compensation established pursuant to sections 143 and 144 of this title shall be applied uniformly, irrespective of whether the employee or individual concerned is a citizen of the United States or a citizen of the Republic of Panama. 76A Stat. 17.

2 C.Z.C. § 146. *Additional allowance and differential.*

In addition to established basic compensation, there shall be paid to each employee who is a citizen of the United States such amounts as the head of the department concerned determines to be payable, as follows:

(1) an allowance for taxes which operate to reduce his disposable income in comparison with the disposable incomes of those employees who are not citizens of the United States; and

(2) an overseas (tropical) differential not in excess of an amount equal to 25 percent of the aggregate amount of the rate of basic compensation so established and the amount of the allowance provided in accordance with paragraph (1) of this section. 76A Stat. 17.

* * * * *

2 C.Z.C. § 148. *Benefits based on compensation.*

For the purpose of determining:

(1) amounts of insurance under the Federal Employees' Group Life Insurance Act of 1954, as amended (5 U.S.C., sec. 2091, *et seq.*) [now 5 U.S.C. § 8702, *et seq.*];

(2) amounts of compensation for death or disability under the Federal Employees' Compensation Act as amended (5 U.S.C., sec. 751 *et seq.*) [now 5 U.S.C. § 8102, *et seq.*];

(3) amounts of overtime pay or other premium compensation;

(4) benefits under the Civil Service Retirement Act, as amended (5 U.S.C., sec. 2251, *et seq.*) [now 5 U.S.C. § 8331, *et seq.*];

(5) annual leave benefits; and

(6) other benefits related to basic compensation—The basic compensation of each employee who is a citizen of the United States shall include the rate of basic compensation established for his position, and the amount of the allowance and differential determined, in the manner respectively provided by sections 144 and 146 of this title.

* * * * *

2 C.Z.C. § 155. *Administration by President; regulations; delegation of authority.*

(a) The President shall coordinate the policies and activities of the respective departments under this subchapter, and may promulgate regulations necessary and appropriate to carry out the provisions and accomplish the purposes of this subchapter.

(b) The President may delegate any authority vested in him by this subchapter, and may provide for the redelegation of any such authority. 76A Stat. 19.

* * * * *

Pursuant to the authority contained in the 1958 Act (2 C.Z.C. § 155(b) quoted above), the President issued Executive Order 10794 on December 10, 1958, 3 C.F.R. at 430–31 (1954–1958 Comp.) in which he delegated the authority granted by Congress to the President in 2 C.Z.C. §§ 142, 155(a) (1962 Ed.), to the Secretary of the Army. Pursuant to Executive Order 10794, the Secretary of the Army issued regulations on January 15, 1959, 24 F.R. 352, 5 C.F.R. § 1201 *et seq.* (1964 Ed.) providing in pertinent part as follows:

5 C.F.R. § 1201, *et seq.* (1964 Ed.)

§ 1201.3 *Coverage.*

(a) *Coverage.* The regulations in this chapter apply to all employees or applicants for employment, irrespective of citizenship, unless excluded in accordance with paragraph (b) of this section.

(b) *Exclusions.* The Secretary of the Army may, upon recommendation of the agency concerned, exclude employees or positions from the provisions of the Act or the regulations in this chapter or any provision of the Act or the regulations in this chapter and may extend rights and privileges to employees as provided in section 3(b) of the Act. * * * Positions and employees excluded from the provisions of the Act or the regulations in this chapter are published in § 1201.100.

* * * * *

§ 1201.100 *Exclusions.*

Pursuant to the provisions of § 1201.3(b) the following positions and incumbents thereof are excluded, to the extent indicated, from the provisions of the Act of July 25, 1958 (72 Stat. 405) and such regulations:

(a) The following positions, and the incumbents thereof, are excluded from all of the provisions of the Act, except section 16 thereof, and the regulations in this chapter.

(1) General Officers of the Panama Canal Company.

(2) Persons in the active military, naval, or public health service of the United States appointed to or employed by the Panama Canal Company or Canal Zone Government.

(3) The United States Attorney and Assistant United States Attorneys and the United States Marshal, Chief

Deputy United States Marshal, and Deputy United States Marshals for the Canal Zone.

(4) The magistrates.

(5) Hospital residents and interns, and other student hospital employees in those categories for which maximum stipends have been prescribed by the Civil Service Commission pursuant to statute.

(6) Consultants and experts when employed under the provisions of section 15, Act of August 2, 1946, (5 U.S.C. 55a) or other statutory authority.

(7) Any employee excluded by the Act of June 19, 1952, as amended (5 U.S.C. [1964 Ed.] 150k), from coverage under laws administered by the Civil Service Commission. [Non-appropropriated fund activity employees.]

(8) Inmate employees of Corozal Hospital and the Palo Seco Leprosarium.

(9) Public Defender.

(10) The probation and parole officer and deputy parole and probation officers.

(11) Chauffeur, Car of President, Panama Canal Company.

(12) Caretaker and service employees assigned to residence of the Governor of the Canal Zone.

* * * * *

§ 1204.1 *Uniformity of job classification standards.*

In order to apply the provisions of section 6 of the Act concerning uniform application of rates of basic compensation, job classification standards shall be uniform within and among all departments. Any problems arising in achieving such uniformity which cannot be resolved among the departments shall be referred to the Board for resolution. If resolution is not achieved they shall then be forwarded to the Secretary of the Army for decision.

§ 1204.2 *Uniformity of compensation.*

The rates of basic compensation for positions and employees, the overseas (tropical) differential and additional approved additives, such as tax factor, shall be uniform within and among all departments. Any problems arising in achieving such uniformity shall be referred to the Board for resolution. If resolution is not achieved they shall then be forwarded to the Secretary of the Army for decision.

Concurring Opinion by Judge Skelton

On August 18, 1964, the President issued Executive Order 11171, 3 C.F.R. at 174–176 (1964 Supp.), which supplemented Executive Order 10794.

Executive Order 11171 provided in pertinent part as follows:

> By virtue of the authority vested in me by Section 155 of Title 2 of the Canal Zone Code (76A Stat. 19), and as President of the United States, it is hereby ordered as follows:
>
> * * * * *
>
> SEC. 2. (a) Subject to the further provisions of this order, there is delegated to the Secretary of the Army the authority vested in the President by Sections 142 and 155 of Title 2 of the Canal Zone Code:
>
> (1) To exclude any employee or position from any or all provisions of subchapter III.
>
> * * * * *
>
> (3) To coordinate the policies and activities of the respective departments under subchapter III.
>
> (4) To promulgate such regulations as may be necessary and appropriate to carry out the provisions and accomplish the purposes of subchapter III.
>
> (b) The Secretary of the Army may redelegate any of the authority delegated to him by subsection (a) of this section.
>
> (c) In promulgating regulations pursuant to the authority delegated by this section (including regulations with respect to the matters covered by Sections 3 and 4 of this order), the Secretary of the Army shall give effect to the following-described policies:
>
> (1) Employment standards, rates of basic compensation, availability of training facilities and programs shall be applied uniformly among all departments in the Canal Zone to all employees irrespective of whether they are citizens of the United States or of the Republic of Panama.
>
> * * * * *
>
> (3) Exclusions of employees or positions from any or all provisions of subchapter III and the extension of rights and privileges to employees, as provided in Section 142(b) of Title 2 of the Canal Zone Code, shall be made only in accordance with regulations issued under this order. Such regulations shall provide for excluding employees or positions from the Canal Zone Merit System only for reasons for which exclusions or exceptions are made from the competitive civil service.

All Canal Zone employees of the United States Government received a tropical differential allowance of 25 percent of their basic salary or compensation under the foregoing applicable statutes and Executive Orders from 1914 until October 10, 1964, when the Secretary of the Army issued regulations, 29 F.R. 14024, 5 C.F.R. § 1204.12 (1964 Rev.), now transferred by 31 F.R. 12202, 12344 to 35 C.F.R. § 253.135 (1967 Rev.), which reduced the differential allowance to 15 percent for certain persons and eliminated it entirely for certain other persons. These regulations provided in pertinent part as follows:

§ 253.135 *Tropical differential*

(a) An overseas, tropical differential for U.S. citizen employees who qualify under the provisions of paragraph (b) of this section shall be fixed by the head of each department in an amount equal to 15 percent of the aggregate compensation established under §§ 253.131 and 253.134. Such differential shall be reviewed periodically by the Secretary of the Army and adjusted to the extent necessary to furnish a suitable incentive in recruitment of qualified personnel and to provide pay benefits substantially equal to those accorded U.S. citizens employed by the Federal Government in comparable foreign areas.

(b) The tropical differential shall be paid to employees who are U.S. citizens except those in the following categories:

(1) A married woman whose husband resides in the Canal Zone or the Republic of Panama. This exclusion shall not apply to such a married woman if she establishes to the satisfaction of her department that:

(i) Her husband is physically or mentally incapable of self-support;

(ii) She is legally separated; or

(iii) Her husband is 51 percent or more dependent upon her for his support.

(2) A child or stepchild of a resident of the Canal Zone or the Republic of Panama who is under 21 years of age and unmarried or who, regardless of age or marital status, does not maintain a separate household.

(c) Notwithstanding the provisions of paragraphs (a) or (b) of this section, each U.S. citizen employee in service on October 11, 1964, shall retain as a fixed tropical differential an amount equal to 25 percent of the aggregate compensation established under §§ 253.133 and

253.134 for the grade and pay step to which he was assigned on July 20, 1964, or if employed after that date, for the grade and pay step to which he would have been assigned had he been employed on July 20, 1964. Calculation of the fixed differential shall be made without reference to any retroactive pay increases authorized subsequent to July 20, 1964. If the employee's aggregate compensation is reduced after July 20, 1964, by reason of demotion or otherwise, his fixed differential shall be adjusted to the rate which he would have retained had he been assigned the lower grade or pay step on July 20, 1964. The retained rate of tropical differential shall continue to be paid only until one of the following events occurs:

(1) There is a break in service of one day or more;

(2) A 2-year period has elapsed since October 11, 1964, and the employee is at that time, or thereafter becomes, ineligible to receive the differential under the conditions prescribed by paragraph (b) of this section; or

(3) The employee becomes eligible for the same or a greater amount of differential under paragraphs (a) and (b) of this section. When the fixed differential is discontinued under this subparagraph due to payment of compensation under § 253.155 for an additional pay assignment, it shall be reinstated upon termination of such assignment.

(d) An employee may be paid tropical differential under this section only to the extent that such payment, when combined with his aggregate compensation established under §§ 253.133 and 253.134, does not exceed the current rate of step 5, GS–17, of the General Schedule of the Classification Act of 1949, as amended.

After the Secretary of the Army issued the regulations in 35 C.F.R. § 253.135 in 1964, quoted above, a group of married women, including plaintiff Hendricks, who were Canal Zone employees of the United States, filed a suit in this court entitled *Margaret J. Hendricks* v. *United States*, No. 202–68 for recovery of the differential allowance that had been denied them by the 1964 regulations, claiming that the 1964 regulations discriminated against them. The case was settled by agreement of the parties on May 7, 1971, covering the claims of the then plaintiffs for the differential allowance for the period from October 11, 1966 to and including January 9, 1971. The settlement was made without prejudice to the rights of the plaintiffs to claim the differen-

tial allowance for the period beginning with and subsequent to January 10, 1971. The prior case has nothing to do with the instant case wherein the plaintiffs are claiming the differential allowance for the period after January 10, 1971. However, it should be pointed out that the regulations have been materially changed by the regulations of 1971 and 1974, quoted below, which are quite different from the regulations of 1964 under which the prior suit was filed, and, consequently, the claims of the plaintiffs here differ in many material ways with the claims of the plaintiffs in that unreported case.

On December 22, 1970, the Secretary of the Army promulgated in 35 F.R. 19750–19751 the following changes, in pertinent part, in 35 C.F.R. § 253.135(b), effective January 10, 1971:[1]

§ 253.135 *Tropical differential.*

* * * * *

(b) The tropical differential shall be paid to employees who are U.S. citizens except as provided in the following subparagraphs:

(1) When a U.S. citizen employee is married to another U.S. citizen employee, the differential may be paid to one spouse only.

(2) When a U.S. citizen employee is married to a person not employed by a department such employee is eligible to receive the differential only if such employee is the member of the family whose job may reasonably be deemed to be the job which determines the location of the family in the area. The spouse of a person serving in the U.S. military forces in the area shall not be deemed to be a person whose job determines such location.

(3) A child or stepchild of a resident of the Canal Zone or the Republic of Panama who is under 21 years of age and unmarried is not eligible.

These provisions were applied to the plaintiffs until April 28, 1974, when the following changes in 35 C.F.R. § 253.135(b), published by the Secretary of the Army on April 16, 1974, 39 F.R. 13650–13651, became effective:

* * * * *

[1] No change was made in 35 C.F.R. § 253.135(a) of the 1964 regulations quoted above.

(b) The tropical differential shall be paid to employees who are U.S. citizens except as provided in the following subparagraphs:

(1) When a U.S. citizen employee is married to another U.S. citizen employee, the differential may be paid to one spouse only.

(2) The U.S. citizen employee whose spouse is a member of a U.S. military service stationed in the area may be paid the differential only to the extent the amount of the differential otherwise payable exceeds the amount of the total housing allowance (BAQ plus the housing portion of the station allowance) established for Panama City, Republic of Panama for a military member having the same rank and family size as the employee's military spouse. The U.S. citizen employee whose spouse, by reason of U.S. Government employment in the Republic of Panama, is eligible under the Department of State Standardized Regulations (Government Civilians, Foreign Areas) (DSSR) for a living quarters allowance (LQA) may be paid the differential only to the extent the amount of the differential otherwise payable exceeds the amount of LQA established for Panama City, Republic of Panama by sections 920 and 932.22 of the DSSR for one in the same quarters group and with the same family size as the employee's spouse.

(3) A child or stepchild of a resident of the Canal Zone of the Republic of Panama who is under 21 years of age and unmarried is not eligible.

Before considering the various contentions and arguments of the plaintiffs, I wish to point out that the purpose of the tropical differential was as stated by the Fifth Circuit Court of Appeals in *Leber* v. *Canal Zone Central Labor Union & Metal Trades Council*, 383 F. 2d 110 (1967), *cert. denied sub nom. Bramlett* v. *Leber*, 389 U.S. 1046 (1968) as follows:

> The purpose of the differential is admitted to be an inducement to get American citizens to work overseas in so-called hardship areas and to alleviate some of the financial burdens of taking such employment. * * * [*Id.* at 120.]

This purpose is also shown in the text of the 1971 regulations where it is stated that Section 253.135(a) provides for periodic review and adjustment by the Secretary of the Army:

> * * * [T]o the extent necessary to furnish a suitable incentive in recruitment of qualified personnel and to

provide pay benefits substantially equal to those accorded U.S. citizens employed by the Federal Government in comparable foreign areas.

This discretionary authority vested in the President and delegated to the Secretary of the Army appears to be laudable and reasonable. The controlling statute is 2 C.Z.C. § 142 (b) (1) which gives the President, and through him, the Secretary of the Army full discretion and authority to exclude any employee or position from the coverage of the Act that provides for the payment of a tropical differential allowance. See the *Leber* case, *supra* (383 F. 2d 110, 116–19).

The Secretary of the Army, in promulgating the two versions of 35 C.F.R. § 253.135 that are currently under review herein, (1971 and 1974), has exercised the discretion vested in him with the result being that the various plaintiffs are employees who have been excluded from the coverage of the tropical differential. In an analogous situation, the court in *Port Authority of Saint Paul* v. *United States*, 193 Ct. Cl. 108, 432 F. 2d 455 (1970), relying upon the Supreme Court's decision in *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965), stated that:

> * * * [T]o sustain an administrative interpretation of a regulation issued by it, it is not necessary to find that the agency construction is the only reasonable one, or even that it is the result a court would have reached had the question arisen in the first instance in judicial proceedings.
>
> Where administrative control has been authorized by Congress, the judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body. *Mississippi Valley Barge Line Co.* v. *United States*, 292 U.S. 282, 286–87 (1934). [*Id.* at 120, 432 F. 2d at 461.]

The regulations in question appear to have a rational basis and purpose and evidence a valid exercise of discretion by the Secretary of the Army.

There are four basic categories of United States citizen-employees who were made ineligible to receive the differential under the regulation of the Secretary of the Army which became effective on January 10, 1971. Each of these

is a category of persons to whom the Secretary of the Army determined it was not necessary to offer a recruitment incentive:

(1) An employee whose spouse also is a Government employee and who also is the family member who has elected to receive the differential (35 C.F.R. § 253.135(b)(1)). Where one spouse of a family unit is living and working in the Canal Zone and is being paid a differential as an inducement to live and work there, it is a valid presumption that no further incentive is necessary to induce the husband or wife to live in the Canal Zone.

(2) An employee member of a family unit whose presence in the Canal Zone is attributable to the job of his or her spouse. (35 C.F.R. § 253.135(b)(2)). Where a family has chosen to make the Canal Zone its home, because of the employment of one spouse in the private sector, it is unnecessary to pay a differential to the husband or wife in order to keep him or her in the area for employment by the United States Government.

(3) An employee whose spouse is serving in the United States military forces and who is assigned to the Canal Zone area (35 C.F.R. § 253.135(b)(2)). When one spouse is stationed in the area as an active duty member of the United States Armed Forces, and the family, if it opted to set up a residence in the Canal Zone, is provided rent free quarters or a quarters allowance, the husband or wife has sufficient incentive to live in the area without receipt of the tropical differential.

(4) An employee who was under 21 years of age, unmarried and the child or stepchild of a resident of the Canal Zone or the Republic of Panama (35 C.F.R. § 253.135(b)(3)). It is sufficient to note that a person who is under 21 and unmarried is a minor under the Canal Zone Code and that such persons are entitled to parental support and could not normally maintain a separate household (4 C.Z.C. § 31, 76A Stat. 78). However, it is also quite obvious that in almost all instances when an individual who graduates from high school, or otherwise enters the labor market while a resident of the Canal Zone, that individual is not present in

the Canal Zone for any reason other than his or her family unit resides there and the presence of these individuals in the Canal Zone would not be affected by the payment or nonpayment of a tropical differential.

Effective April 28, 1974, the regulation was modified to allow payment of the differential in certain cases in which it had previously been withheld (35 C.F.R. § 253.135(b)(2)(1974)). The "reason for being in the area" test (subparagraph (2) above) was eliminated because it had proven too difficult and costly to administer due to the requirement to analyze the subjective factors specified for consideration. In the case of employees married to members of the armed forces (subparagraph (3) above) or to other Government employees eligible to receive a quarters allowance, the differential may now be paid, but only insofar as it exceeds the amount of such a quarters allowance. This change was instituted because, for employment purposes, it was determined that this inducement *may* be required to lure the spouse into the Canal Zone.

While plaintiffs' petitions do not so state, it is presumed that these cases are filed in this court under the Tucker Act, 28 U.S.C. § 1491 (1970), which provides in pertinent part as follows:

> The Court of Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress, or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort. * * *

The plaintiffs say that they base their claims on the following statutes and regulations:

> 1. Act of August 24, 1912, ch. 390, § 4, 37 Stat. 560, 561, now codified as 2 C.Z.C. § 101 (1962 Ed.);
> 2. Act of July 25, 1958, 72 Stat. 405, *et seq.*, also known as Pub. L. 85–550, now codified in pertinent part as 2 C.Z.C. §§ 141, 156 (1962 Ed.);
> 3. The provisions of 5 U.S.C. § 7152(a) (Supp. I, 1971);

4. Regulations of the Secretary of the Army, issued on January 15, 1959, 24 F.R. 352, 5 C.F.R. § 1204.2 (1964 Rev.);

5. Regulations of the Secretary of the Army promulgated on October 10, 1964, 29 F.R. 14024, as amended on January 10, 1971, 35 F.R. 19750–19751, 35 C.F.R. § 253.135 (1973 Rev.); and

6. Part 713, Federal Personnel Manual § 4.3.

The plaintiffs attack the 1971 and 1974 regulations that exclude them from the benefits of the differential allowance and say that such regulations are invalid for various reasons which I will consider below. They argue that since the regulations are void, they are entitled to a money judgment for the differential allowance from January 10, 1971, up to the date of judgment in this case.

In the first place, plaintiffs contend that the regulations are void because they conflict with the statute, 2 C.Z.C. § 146. They say that 2 C.Z.C. § 146 requires the payment of a differential allowance to each employee who is a citizen of the United States. I do not so construe the statute. The plain wording of the statute is contrary to plaintiffs' position. The statute provides:

> 2. C.Z.C. § 146. *Additional allowance and differential.*
>
> In addition to established basic compensation, *there shall be paid* to each employee who is a citizen of the United States *such amounts as the head of the department concerned determines to be payable*, as follows:
>
> * * * * *
>
> (2) *an overseas* (*tropical*) *differential* not in excess of an amount equal to 25 percent of the aggregate amount of the rate of basic compensation so established and the amount of the allowance provided in accordance with paragraph (1) of this section. 76A Stat. 17. [Emphasis supplied.]

It is clear that the statute provides for the payment of "such amounts as the head of the department [Secretary of the Army] determines to be payable" as a differential. The Secretary of the Army has determined that *no amount* shall be paid to the plaintiffs as a differential, because he has excluded them from the benefits of the differential allowance in the Act. There is no question that he had the authority

to so exclude the plaintiffs because 2 C.Z.C. § 142(b)(1) provides:

> (b) To the extent he deems appropriate, the President may:
> (1) exclude any employee or position from this subchapter or from any provisions of this subchapter; * * * 76A Stat. 16.

Of course, the Secretary of the Army exercised the authority of the President by appointment and delegation from him as shown by the various Executive Orders quoted above. The exclusion of the plaintiffs by the Secretary of the Army was a valid exercise of the authority delegated to him. See *Leber*, *supra*. Accordingly, instead of the statute mandating the payment of the differential to the plaintiffs, it actually denied them the differential. Plaintiffs' argument in this regard must be rejected.

The plaintiffs argue that the regulations are invalid because they do not comply with 2 C.Z.C. §§ 144, 145 which provide that the rates of basic compensation shall be applied uniformly. This argument is unpersuasive. It will be observed that *basic compensation* is different from the differential allowance. This is shown by 2 C.Z.C. § 146 where it is stated:

> *In addition to established basic compensation*, there shall be paid * * *.
> (2) an overseas (tropical) differential * * * . [Emphasis supplied.]

The plaintiffs contend that the regulations discriminate against them because of their marital status in violation of 5 U.S.C. § 7152 and 7154(b) (Supp. III, 1973), which renders them void.

Section 7152 as amended by section 3 of Pub. L. 92-187, December 15, 1971, 85 Stat. 644, 5 U.S.C. § 7152 (Supp. III, 1973) now provides:

> § 7152 Marital status.
> (a) The President may prescribe rules which shall prohibit, as nearly as conditions of good administration warrant, discrimination because of marital status in an Executive agency or in the competitive service.
> (b) Regulations prescribed under any provisions of this title, or under any other provision of law, granting

benefits to employees, shall provide the same benefits for a married female employee and her spouse and children as are provided for a married male employee and his spouse and children.

(c) Notwithstanding any other provision of law, any provision of law providing a benefit to a male Federal employee or to his spouse or family shall be deemed to provide the same benefit to a female Federal employee or to her spouse or family.

Section 7152 requires that married females be treated in the same way that married males are treated and that unmarried males and unmarried females are to be treated alike. The facts in this case show that those in each group were treated equally with each other. That the regulations do not discriminate against women because of sex is clearly evidenced by the fact that the regulations under attack herein are currently challenged in the district court by three male employees of the Panama Canal Company. *Garcia* v. *Callaway*, Civil No. 74–779 (D.D.C.), who claim they are discriminated against by the regulations because they are males.

Also, 2 C.Z.C. § 146 provides that "There shall be paid to *each employee* [male or female, single or married] * * *" a differential allowance. Regulation 35 C.F.R. § 253.135(b) provides that "The tropical differential shall be paid to *employees* who are U.S. citizens * * * [man or woman]." [Emphasis supplied.] Thus, both the statutes and the regulations treat married men and married women alike, and treat single men and single women alike, and there is no discrimination because of sex. This analysis also answers plaintiffs' argument that the regulations violate 5 U.S.C. § 7154(b) (Supp. III, 1973) because they discriminate against plaintiffs on account of sex. That regulation provides as follows:

§ 7154. Other prohibitions.

* * * * *

(b) In the administration of * * * subchapters III and IV of chapter 53, * * * of this title, discrimination because of race, color, creed, sex, or marital status is prohibited with respect to an individual or a position held by an individual.

Plaintiffs not only contend that the regulations discriminate against them because of sex, but also because of their marital status as married women. This argument is based on their allegation that the differential is paid to all single women over 21, but is denied to plaintiffs because they are married, and that this is a discrimination based on marital status prohibited by 5 U.S.C. §§ 7152, 7154. Whether this is a discrimination prohibited by these statutes may be questionable because plaintiffs' husbands have received the differential allowance and it is logical to assume that the plaintiffs have received at least some indirect benefit from the differential allowance granted to their husbands. However, it does appear that the plaintiffs as married women receive treatment as to the differential that is different to some extent to the treatment received by single women over 21. The plaintiffs say this is a violation of sections 7152 and 7154(b) and that by reason thereof they are entitled to recover money damages from the United States. This theory of the plaintiffs is unpersuasive. Even if this unequal treatment of plaintiffs as compared to single women is a violation of these statutes, it is not a violation that allows the plaintiffs to recover a money judgment against the Government. This is true because of the discussion that follows.

Sections 7152 and 7154(b) are not self-executing. They, like 5 U.S.C. § 5301(a)(1) (equal pay for equal work) also relied on by plaintiffs, are announcements of policy that provide no penalty if not complied with. They do not mandate the payment of any money to anyone if violated. Neither do they create any substantive rights in any employee in the Canal Zone that will support a claim for money damages from the United States.

The Supreme Court has occasion to decide this very question in a recent unanimous opinion in *United States* v. *Testan*, 424 U.S. 392 (1976). In that case the plaintiffs were attorneys who claimed they were wrongfully classified in a grade lower than attorneys in another agency who were doing the same kind of work. They filed suit in the Court of Claims for money damages as back pay under the Classification Act which provides in 5 U.S.C. § 5101 for "equal pay for substantially equal work," and under the Back Pay

Act, 5 U.S.C. § 5596(b). In reversing the decision of the Court of Claims, which had remanded the case to the Civil Service Commission, the Supreme Court made many pronouncements that are applicable and very much in point in the instant case. The Supreme Court pointed out that the jurisdiction of the Court of Claims is limited to claims for "actual, presently due money damages from the United States," citing *United States* v. *King*, 395 U.S. 1 (1969). The Court went on to hold that the Tucker Act is only a jurisdictional Act which does not create any substantive rights against the United States for money damages, and that it merely *confers jurisdiction on the Court of Claims whenever the substantive right exists.* In this regard, the Court held:

> The Tucker Act, of course, is itself only a jurisdictional statute; it does not create any substantive right enforceable against the United States for money damages. The Court of Claims has recognized that the Act merely confers jurisdiction upon it whenever the substantive right exists. *Eastport Steamship Corp.* v. *United States*, 178 Ct. Cl. 599, 605–607, 372 F. 2d 1002, 1007–1009 (1967). We therefore must determine whether the two other federal statutes that are invoked by the respondents confer a substantive right to recover money damages from the United States for the period of their allegedly wrongful civil service classifications. [*Id.* at 398.]

The Court then considered the Classification Act which provides for equal pay for substantially equal work, and held that the Act nowhere provides for an award of back pay to a person who has been erroneously classified. This is analogous to the claims of the plaintiffs in the instant suit that they have not been given "equal pay for equal work;" that the salaries have not been applied uniformly to all employees; that they have been discriminated against because of sex and marital status. But as was the case in *Testan* with regard to the Classification Act, none of the statutes or regulations on which the plaintiffs base their claims provide for payment of money to an employee under the circumstances which they allege exist.

The Supreme Court held in *Testan* with regard to the Classification Act:

> * * * [I]t is implicit in the court's decision in favor of respondents that a violation of the Classification Act gives rise to a claim for money damages for pay lost by reason of the allegedly wrongful classifications.
>
> It long has been established, of course, that the United States, as sovereign, "is immune from suit save as it consents to be sued * * * and the terms of its consent to be sued in any court define that court's jurisdiction to entertain the suit." *United States* v. *Sherwood*, 312 U.S., at 586. And it has been said, in a Court of Claims context, that a waiver of the traditional sovereign immunity "cannot be implied but must be unequivocally expressed." *United States* v. *King*, 395 U.S., at 4; *Soriano* v. *United States*, 352 U.S. 270, 276 (1957). Thus, except as Congress has consented to a cause of action against the United States, "there is no jurisdiction in the Court of Claims more than in any other court to entertain suits against the United States." *United States* v. *Sherwood*, 312 U.S., at 587–588.
>
> *We find no provision in the Classification Act that expressly makes the United States liable for pay lost through allegedly improper classifications.* To be sure, in the "purpose" section of the Act, 5 U.S.C. § 5101, Congress stated that it was "to provide a plan for classification of positions whereby * * * the principle of equal pay for substantially equal work will be followed." And in subsequent sections, there are set forth substantive standards for grading particular positions, and provisions for procedures to ensure that those standards are met. *But none of these several sections contains an express provision for an award of back pay to a person who has been erroneously classified.* [Emphasis supplied.] [*Id.* at 399–400.]

> * * * As stated above, the Tucker Act is merely jurisdictional, and grant of a right of action must be made for specificity. The respondents do not rest their claims upon a contract; neither do they seek the return of money paid by them to the Government. *It follows that the asserted entitlement to money damages depends upon whether any federal statute "can fairly be interpreted as mandating compensation by the Federal Government for the damage sustained." Eastport Steamship Corp.* v. *United States*, 178 Ct. Cl., at 607, 372 F. 2d at 1009; *Mosca* v. *United States*, 189 Ct. Cl. 283, 290, 417

F. 2d 1382, 1386 (1969), cert. denied, 399 U.S. 911 (1970). * * * [Emphasis supplied.] *Id.* at 400.]

* * * Where the United States is the defendant and the plaintiff is not suing for money improperly exacted or retained, the basis of the federal claim—whether it be the Constitution, *a statute, or a regulation—does not create a cause of action for money damages unless, as the Court of Claims has stated, that basis "in itself" "can fairly be interpreted as mandating compensation by the Federal Government for the damage sustained." Eastport Steamship Corp.* v. *United States*, 178 Ct. Cl., at 607, 372 F. 2d, at 1008–1009. We see nothing akin to this in the Classification Act or in the context of a suit seeking reclassification. [Emphasis supplied.] [*Id.* at 401–402.]

The Supreme Court then considered the Back Pay Act and held that it did not apply to wrongful classification claims. The Court said:

C. The Back Pay Act. This statute, which the Court of Claims found unnecessary to evaluate, in arriving at its decision, does not apply, in our view, to wrongful classification claims. The Act does authorize retroactive recovery of wages whenever a federal employee has "undergone an unjustified or unwarranted personnel action that has resulted in the withdrawal or reduction of all or a part of the compensation to which the employee is otherwise entitled." 5 U.S.C. § 5596(b). The statute's language was intended to provide a monetary remedy for wrongful reductions in grade, removals, and suspensions, * * *.

* * * * *

* * * [T]he Back Pay Act, as its words so clearly indicate, was intended to grant a monetary cause of action only to those who were subjected to a reduction in their duly appointed emoluments or position.

III

We therefore conclude that neither the Classification Act nor the Back Pay Act creates a substantive right in the respondents to backpay for the period of their claimed wrongful classifications. * * * [*Id.* at 407.]

The significance of the *Testan* case and its applicability to the instant case is that since the plaintiffs are not suing on contracts nor for money improperly exacted or retained, but are suing for money on the basis of the recited statutes and

regulations, they have not alleged a cause of action for money damages unless the statutes or regulations in themselves "can fairly be interpreted as mandating compensation by the Federal Government for the damages sustained." The statutes and regulations relied upon by the plaintiffs cannot be so interpreted. None of them mandate the payment of money to the employees of the United States in the Canal Zone, except 2 C.Z.C. § 146 and regulation 35 C.F.R. § 253.135 of 1971 and as amended in 1974. But this statute and these regulations are of no help to the plaintiffs. It is clear that 2 C.Z.C. § 146 provides for the payment of such amounts as the head of the department (The Secretary of the Army) determines to be payable as a differential allowance. He determined that no differential allowance should be paid to the plaintiffs by excluding them from the provisions of the statute providing for the payment of such differential allowance. This exclusion was authorized by 2 C.Z.C. § 142 and also by Executive Orders 10794 and 11171. Regulations 35 C.F.R. § 253.135(a) of 1971 and 1974 provided for the payment of the differential allowance to those who qualified under the provisions of Section 253.135(b). The plaintiffs did not qualify under Section 253.135(b) because by its terms in both the 1971 and 1974 versions the plaintiffs were by the express terms of the regulations excluded from the benefits of the differential allowance payments.

The plaintiffs also rely on 2 C.Z.C. § 101 (quoted above) which provides that the Governor of the Canal Zone shall appoint all employees of the Canal Zone Government and fix their compensation so that it will not exceed by more than 25 percent the compensation paid for the same or similar services to persons employed by the Government in the continental United States. This statute is of no help to the plaintiffs for several reasons. In the first place, the statute speaks of "compensation" which within the meaning of the various statutes and regulations is different from the "tropical differential allowance" involved here. In the next place, 2 C.Z.C. § 101 does not mention the differential allowance nor authorize the Governor to do anything about it. Furthermore, the amount of compensation fixed by the Governor is discretionary within the 25 percent limit mentioned above, and the statute does not mandate the payment of money to any of the

plaintiffs if their compensation is not fixed at a given amount, which brings their claims within the ambit of the *Testan* decision described above. Finally, and most important, the determination of the amount of the differential allowance and the United States citizen employees to whom it would be paid was vested exclusively in the Secretary of the Army. The court in the *Leber* case held that the wage and employment practices of the Canal Zone Government and of the Panama Canal Company are subject to regulations by the Secretary of the Army as follows:

> The Canal Zone Government and the Panama Canal Company are departments within the meaning of the statutory definition. It is clear, therefore, that wage and employment practices of these two entities are subject to regulation by the Secretary of the Army. He is the official charged with the responsibility of coordinating the policies and activities of the respective departments and promulgating regulations necessary and appropriate to carry out the intent of the statutes. [Footnote omitted.] [383 F. 2d at 114.]

Therefore, it is clear that the plaintiffs have not cited any statute or regulation that mandates the payment of money damages to them because of the alleged discrimination, and for that reason have not alleged a claim on which relief can be granted. Under these circumstances, since the plaintiffs have not shown a substantive right to presently due money damages from the United States, we are not authorized by the Tucker Act to award them a judgment for money damages against the Government. See *Testan*, *supra*.

Of course, as pointed out above, the plaintiffs contend that the regulations in question here are invalid. The Fifth Circuit Court of Appeals had this identical problem before it in *Leber*, *supra*. In that case the regulations of 1964 were attacked as being void. Those regulations reduced the differential allowance from 25 to 15 percent and also excluded certain employees from the benefits of the differential, just as the 1971 and 1974 regulations have done in our case. In that case the court held:

(1) The Secretary of the Army had the authority granted by Congress to the President and delegated by him to the Secretary to pay a differential less than 25 percent.

(2) The reduction of the differential from 25 to 15 percent was within the purview of 2 C.Z.C. § 155 and was not an abuse of discretionary power by the Secretary.

(3) The Secretary could make reasonable exclusion of United States citizens from the benefits of the differential, which he did.

(4) The authority granted by Congress to the President and delegated by him to the Secretary was not an invalid or improper delegation of the legislative power of Congress to officials of the Executive Branch.

(5) The 1964 regulations were valid.

In the *Leber* case the plaintiffs were seeking the differential allowance denied to them by the 1964 regulations. To that extent, their claims were identical in principle to the claims of the plaintiffs under the 1971 and 1974 regulations in the case before us. In my opinion, the well written decision of the Fifth Circuit Court of Appeals in that case was correct, and I would adopt the reasoning and holding of the court there expressed as to issues present in our case that are the same as those found in *Leber*.[2]

We should hold that the current Canal Zone Code, 2 C.Z.C. §§ 31–156 enacted by Congress authorized the President to appoint the Secretary of the Army with authority to administer the Canal Zone Government and to administer the wage and employment practices in the Canal Zone, and to determine the amount of the tropical differential allowance to be paid to United States citizen employees, and to determine which of such employees should receive the differential, and to exclude others (such as the plaintiffs) from the benefits of the differential; that the President did appoint the Secretary of the Army for said purposes and with such authority by Executive Orders 10794 and 11171; that the Secretary exercised such authority through the 1971 and 1974 regulations by reducing the differential from 25 to 15 percent of basic compensation and by excluding certain employees from the benefits of the differential (including the plain-

[2] In *Reinheimer* v. *Panama Canal Co.*, 413 F. 2d 153 (5th Cir. 1969), *on remand*, 344 F. Supp. 510 (D.C.Z. 1972), *aff'd. mem.* 491 F. 2d 1271 (5th Cir. 1974), the court held *on remand* that the exclusion of certain pilots from the benefits of the differential allowance was upheld, and this was affirmed by the Fifth Circuit Court of Appeals.

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tiffs); that such reduction in the differential and the exclusion of plaintiffs from its benefits was not an abuse of discretionary power by the Secretary; that the delegation of authority granted by Congress to the President and delegated by him to the Secretary was not an invalid or improper delegation of the legislative power of Congress to officials of the Executive Department; that the 1971 and 1974 regulations are not contrary to the applicable statutes and Executive Orders and are valid; that the regulations do not discriminate against the plaintiffs on account of sex; and that their discrimination as to martial status is not compensatory.

We should hold further that the plaintiffs have not alleged nor shown any substantive right to receive presently due money damages by reason of the violation of any statute or regulation on which they base their claims that mandate the payment of money to them by the United States; and that without such an allegation and showing, this court is not authorized by the Tucker Act to award them a recovery for money damages against the United States. *See Testan, supra.* It is clear that the plaintiffs have not alleged a claim on which relief can be granted.

I concur in the result reached by the majority and would deny plaintiffs' motion for summary judgment and grant defendant's cross-motion, and dismiss plaintiffs' petitions.

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536 F. 2d 1345

RIXON ELECTRONICS, INC., AND RIXON LIQUIDATING CORP. v. THE UNITED STATES

[No. 475–73. Decided June 16, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; fitness for use of Government-furnished property; release; economic duress; reformation of release.—In 1963 plaintiff was awarded a Navy contract for manufacture of 153 low-frequency radio transmitters (a highly complex radio communication device). Plaintiff alleges that Government-furnished microfilms which it relied on in preparation of its bid and for obtaining interchangeability of components with those procured under prior awards, were not

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received by it in a condition suitable for the intended use, and accordingly that it is entitled to an equitable adjustment for the unanticipated additional costs it incurred. The Armed Services Board of Contract Appeals denied adjustment because, it held, plaintiff released existing claims by Modification No. 2, executed at a time when the subject matter of the claim was in existence and the costs or losses attributable to the deficiency had been incurred. Plaintiff contends that the release is unenforceable because it was signed under economic duress, and that the release should be reformed as signed under mutual mistake not reflecting the true agreement of the parties. It is *held* that the release was not obtained as the result of economic duress. The Government did not bring about the contractor's financial necessity by wrongful or improper conduct. Assuming *arguendo* that the Government did cause contractor's distress, it did not coerce the contractor to sign the release. It is also *held* that neither party thought the release was limited to time-delay issues, and if plaintiff desired to have the microfilm claim excepted from the release it should have so requested. The release was intended to be as sweeping and extensive as its language, it was so understood by both parties, and there is no basis for reformation for mutual mistake. Plaintiff is not entitled to recover, its motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Contracts; duress; economic duress; what constitutes.

[1] To invalidate on the ground of economic duress a contractor's signed release of Government liability under a Government contract or for breach of contract, the wrong by the Government must have caused the contractor's financial distress and the Government must have exploited the distress it had itself created to obtain an unjustified release of a good and valid claim. The mere stress of business conditions will not support duress contentions when the Government is not responsible for the underlying circumstances.

United States ⇐ 74(6)

Contracts; bids; inspection by bidders; failure of bidder to observe, effect of.

[2] Where a potential bidder on a Government contract to supply a complex radio communication device was offered an opportunity to look at proffered microfilms, since the bidder knew or should have anticipated from the Invitation for Bids that the microfilms would be deficient it is bound by what it would have seen if it had looked and whether or not it did look and was thereby misled by what it saw is irrelevant.

United States ⇐ 64

Contracts; bids; confirmation of bid; Government request for.

[3] A contractor's confirmation of its bid after a Government request for review of the bid and verification of the cost estimates, and a warning that the bid was inadequate and that the contractor

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would lose money, is an unreasonable assumption of risk. The fact that the warning was broad and general does not change the situation, particularly where the record shows that the Government did not have superior information with which to pinpoint the errors in bid.

United States ⇐ 64

Contracts; Government-furnished property; warranty of fitness for use.

[4] Where bidders were warned of the highly specialized, complex nature of the subject device involving a high order of workmanship and quality controls, a tight delivery schedule, the necessity for Government approval of the preproduction equipment, that the parts had to be interchangeable part by part with a set previously procured from a sole source, and that the Government did not represent that the microfilms of manufacturing drawings were complete or legible in whole or in any particular part, absent a discrepancy between what the Government furnished and what it warranted in clear and unambiguous contract language, there is no basis legally for a claim that due to Government fault the microfilm was deficient causing the contractor such great expense that he was constrained, under economic duress, involuntarily to agree to a release of existing claims in order to obtain an increase in progress payments.

United States ⇐ 74(6)

Contracts; waiver; delay in asserting rights.

[5] Plaintiff's failure to complain promptly after bid of the deficiencies operates as a waiver, since delay in asserting rights prejudices the Government by running up recoverable costs.

United States ⇐ 64

Contracts; release; economic duress; failure to except claim.

[6] Even assuming that the Government was wrong in furnishing deficient microfilms causing the contractor, because of its poor financial condition, to sign a release of all existing claims in order to obtain an increase in progress payments, the Government loses the benefit of the release only if it used the contractor's financial condition in a coercive manner. Where the record indicates that the Government would have insisted on the release, but would have excepted from the release the microfilm claim here involved had plaintiff mentioned it, the claim that the release was obtained by economic duress is not sustainable.

United States ⇐ 74(6)

Contracts; reformation; mutual mistake.

[7] The release of all existing claims, to obtain an increase in progress payments, was understood by both parties to be as sweeping and extensive as its language. It cannot be reformed for mutual mistake since at the time the release was agreed upon, neither side

thought the release was limited to time-delay issues, as the proposed reformation would provide.

United States ⇐ 74(6)

Stephen B. Clarkson, for plaintiff. *Henry G. Beauregard*, attorney of record. *Thomas J. Touhey*, and *Sullivan, Beauregard & Clarkson*, of counsel.

Marc J. Fink, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before NICHOLS, KUNZIG, and BENNETT, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

This case is before us on defendant's request for review of a recommended decision of Trial Judge David Schwartz, which he submitted in accordance with Rule 166(c). The case is a contract dispute governed by the Wunderlich Act, 41 U.S.C. Secs. 321, 322. A decision of the Armed Services Board of Contract Appeals (ASBCA), 72-1 BCA ¶ 9323, denied the claim. Trial Judge Schwartz would have us reverse this decision and grant summary judgment to the plaintiff, with remand to the ASBCA for quantum. Though we are greatly aided by his able analysis, we reach the opposite result after careful consideration of the record, briefs and oral arguments of counsel. We conclude that the ASBCA, despite some errors of law, arrived at the right result. Therefore its decision is affirmed, and the petition is dismissed.

Plaintiff, Rixon Electronics, Inc. (here joined by its liquidating successor), was awarded a Navy contract for the manufacture of 153 low-frequency radio transmitters for shipboard use. Under circumstances of great difficulty and stress, it performed the contract. The claim demands an equitable adjustment as provided in the "Government Furnished Property" and "Changes" articles, and, in the second and third counts, reformation of a certain release, to be discussed presently. Certain microfilms, Government furnished, were relied on in preparation of plaintiff's bid, plaintiff says, and for obtaining interchangeability of components with those procured under prior awards. They were not, says

plaintiff, "received by the contractor in a condition suitable for the intended use," in the language of the "Government Furnished Property" clause, thus generating a duty in the Contracting Officer to make an equitable adjustment. It seems to be agreed by all concerned that they were grossly defective, to the plaintiff's considerable detriment. The ASBCA, however, denied any such adjustment because, it held, the plaintiff released its claim by Modification No. 2, executed at a time when the subject matter of the claim was in existence and the costs or losses attributable to the deficiency had been incurred. The release reads as follows:

> The Contractor further agrees that in consideration of the above modification, the Contractor for itself, its successors and assigns here remises, releases, and forever discharges the Government, its officers, agents, and employees of and from all liabilities, obligations, claims and demands whatsoever arising under or in any manner connected with this contract, the subject matter of which was in existence on or prior to the date of this modification (whether or not asserted by or known to the Contractor and whether costs, losses, and expenses attributable thereto were incurred prior to or after the date of this modification), excepting only claims for payments of amounts due and payable to the Contractor under the terms of this contract.

It is agreed by all that this release, if enforced according to its terms, bars the instant claim. The reasons alleged for not enforcing it are two: first, it was signed under "economic duress", second, it should be "reformed" as signed under "mutual mistake" not reflecting the true agreement of the parties. We deal with these two points in order.

There is much law on the nature of the "economic duress" that will invalidate a government contractor's signed release of liability under a Government contract, or for breach of it. We will assume for present purposes that the trial judge stated correctly that it must be a case where:

> 1. * * * the Government is responsible for the contractor's financial necessity, in the sense of having brought it about by wrongful or improper conduct, * * *

that is, wrong by the Government must have caused the contractor's distress. Next:

> 2. * * * the involuntary nature of the victim's assent, given without reasonable alternative, usually to avoid irreparable damage and a coercive or wrongful act by the other party.

That is, the Government must have exploited the distress it had itself created, to obtain an unjustified release of a good and valid claim. *Urban Plumbing & Heating Co.* v. *United States*, 187 Ct. Cl. 15, 28–33, 408 F. 2d 382, 389–92 (1969), *cert. denied*, 398 U.S. 958 (1970); *Fruhauf Southwest Garment Co.* v. *United States*, 126 Ct. Cl. 51, 61–63, 111 F. Supp. 945, 951–52 (1953). Some wrongful conduct must be shown to shift to defendant the responsibility for bargains made by plaintiff under the stress of financial necessity. The mere stress of business conditions will not support duress contentions when the Government is not responsible for the underlying circumstances. *Fidelity & Casualty Co.* v. *United States*, 203 Ct. Cl. 486, 497, 490 F. 2d 960, 966 (1974); *La Crosse Garment Mfg. Co.* v. *United States*, 193 Ct. Cl. 168, 177, 432 F. 2d 1377, 1382–83 (1970). *See* 13 *Williston On Contracts*, Secs. 1601–03, 1624 (3d ed. 1970); J. Dalzell, *Duress by Economic Pressure*, 20 N.C.L. Rev. 237, 341 (1942).

Let us weigh the trial judge's conclusions by the above criteria, calling them tests 1. and 2.

As to 1. this case is remarkable among Wunderlich cases, in the extraordinary language used by the Government to warn how risky the deal was, that it was offering. A cynic might say the Government was happy with its previous sole source procurement of the item and did not want to deal with anyone else. Never have the small craft warning pennants been larger, redder, or more numerous! It may well be that the Government should pay small contractors the cost of their efforts in performing unusually difficult tasks, for which they are unqualified, regardless of what self-exculpatory language the Government writes into its proposals. But we can neither legislate such an end, nor reach the same result by ignoring the self-exculpatory language and making for the parties a contract other than the one they signed.

The language in the Government proposals, with the inherent difficulty of the task, must be credited with deterring anyone from bidding on the IFB, except the previous sole source and the plaintiff. The former, Westinghouse, bid $17,758.52 per unit to plaintiff's $11,888.45, or $870,550.11 higher for the 153 units to be supplied.

The Government IFB recited that the Radio Transmitting Set called for was a:

> * * * highly specialized, complex radio communication device having extreme accuracy, reliability, stability and long life under the rugged environmental conditions encountered in Navy shipboard service, such as heat, humidity, shock and vibration. They are high quality articles the production of which requires a high order of workmanship and quality controls as well as careful selection of quality parts. To date only one concern has previously produced substantially the same articles as called for herein and had them approved and accepted by the Navy.

The IFB then spelled out that the required delivery schedule was much shorter than in the previous procurement and that delivery times were of paramount importance:

> * * * This Schedule is considered to be extremely tight for firms, even ones highly qualified for the work, who have not previously produced substantially similar articles and had them approved or accepted by the Navy. * * *

The IFB then warns that the time schedule requires that it would be necessary to order parts and materials and commence production before Government approval of the preproduction equipment and:

> * * * the successful bidder must assume all risks associated with production equipment and supplies in advance of notice of approval * * * The bidder represents that he understands the existence and nature of such risks and that he has taken them into consideration in formulating his bid.

Unless the successful bidder were the previous sole source, under these threats he would naturally hope for full cooperation by the Government in supplying information as to exactly what was to be produced. Though facially specifications were "essentially of the performance type," it did not

suffice that the sets should work: by the contract they had to be interchangeable part by part with a set previously procured. However, the Government also gave assurance that its information as to previously procured sets would be entirely undependable. Microfilms of parts would be available for examination before bidding, and would be furnished to the successful bidder. But they were accepted under previous contracts whose specifications:

> * * * may not be identical to the requirements of this contract [!]

They were provided only for:

> * * * such information and assistance as they may provide the Contractor with respect to the general nature of the equipments and repair parts to be delivered under this contract. * * *

As will appear, a clause used in other contracts, that the microfilms would also be useful in obtaining interchangeability, was conspicuously missing here. In addition, a model set of the type to be procured was to be furnished, and this was to be used in meeting interchangeability requirements, but incredible as it may seem, the Government did not:

> * * * represent that the * * * Set meets the requirements of this contract in every respect * * *

It might have been, and in fact was, obtained under a prior contract with different specifications. The Government also, if repetitiously, warned it did not:

> * * * represent that the Microfilm of Manufacturing Drawings is complete or legible in whole or in any particular part or that the drawings from which the microfilm was made are complete and accurate and free from omissions, errors, inconsistencies or other defects and it does not represent that the equipments or repair parts made in accordance with the Government Furnished AN/WRT–1 Radio Transmitting Set and/or Technical Manual and/or Microfilm of Manufacturing Drawings will meet the performance or other requirements of this contract including the specifications referenced directly or indirectly herein.

A bidder who had not previously manufactured a set was required to manufacture and test at its own expense a preproduction prototype.

It might seem incredible that the Government should demand interchangeability and not inform with any accuracy, interchangeable with what? How was the bidder, if not the previous sole source, supposed to know what it was to make? Apparently, as this bidder did it, by taking apart the Government furnished model and "engineering backwards" or in other words making what used to be known as "Chinese copies" of all parts not superseded in the new specifications. As to newly designed parts, that was a little harder, as the ASBCA found.

The trial judge disputes the finding of the ASBCA that the contractor did not look at the microfilms, as it was offered an opportunity to do before bidding. He infers that it looked, and was misled by what it saw, as to the material to be produced. It appears that this is irrelevant, for the contractor knew or should have anticipated from the IFB itself that the microfilms would be deficient. Moreover, whether or not it actually looked, it is bound by what it would have seen if it had looked. The ASBCA has found:

> * * * Moreover, appellant has not shown that if it had examined the microfilm and model made available by the Government before the award at least some of the difficulty encountered reasonably could not have been recognized, anticipated and reflected in its prototype cost estimates. Thus, the general quality of the microfilm, its disorganization, the revisions of the specification under which the microfilm and model were produced, the absence of drawings for the mounting and power supply, and the absence of the MCW modification from both the drawings and model should have been reasonably apparent. The latter intelligence could also have been surmised from the fact that the MCW modification, which which was the largest source of appellant's engineering difficulty, was a new requirement encompassing design effort. * * *

It is clear from this the contractor should have realized it was undertaking original design effort, not just the copying of clearly delineated prototype parts.

The trial judge quotes other ASBCA statements, in a somewhat selective manner, as defendant points out in its brief. He does not quote the above telling passage. We do not perceive any mystery as to what the ASBCA meant to find,

nor can it reasonably be held to lack support in substantial evidence. Everything the plaintiff says as to the defects in these microfilms tends to show more plainly that such defects could not have been entirely overlooked on the preliminary examination. The ASBCA does seem to think that the full enormity of the microfilm defects could only have been realized by one who tried to work with them. Plaintiff bid its bid, however, though it knew or should have known that the microfilms were to some extent defective, constituting a hazard of unknown proportions to the successful and profitable performance of the contract.

The ASBCA and the trial judge, who differ in so much else, join in asserting that the disclaimers here involved are not much different from those in *Thompson Ramo Wooldridge Inc.* v. *United States*, 175 Ct. Cl. 527, 361 F. 2d 222 (1966). This is manifestly incorrect. That case involved a claim for equitable adjustment, or alternatively, for breach of contract, by a contractor for radio transmission equipment who went through an experience much like the plaintiff's here, but signed no relevant release. There were equally bad, or worse microfilms, the same Government furnished property clause, with the same provision for equitable adjustment in case such property was not suitable for its intended use, and the same disclaimers of fitness expressly addressed to the microfilms. But there was an expressed statement that the microfilm would be of assistance in meeting the interchangeability requirement. This was essential to the plaintiff's case because it showed what the "intended use" was for which the warranty was given. The court said, at 547, 361 F. 2d 235:

> Had the Government intended the microfilm only to be "usable and useful [in some way] in obtaining interchangeability", as the Board ruled, it should have stated only the first of the two uses prescribed for the microfilm, *i.e.*, that the film was furnished "for such information and assistance as * * * [it] may provide." The provisional nature of this obligation probably would have saved the Government even for furnishing microfilm of dubious utility (as it did supply). But the Government went further and represented that the microfilm would be suitable for use in producing interchangeable parts and components. To us that necessarily means, in

> this manufacturing contract, that the making of prints was an "intended use" for which the film was furnished. * * *

Here we have the case supposed in dictum in the above passage, where no statement is made in the contract that the microfilm is usable for interchangeability. It is asserted there, however, that the model transmitter is useful for that purpose. The conclusion follows that the disclaimers as to the microfilm, with nothing to contradict them, are effective to state their plain and obvious meaning. In *Thompson Ramo Wooldridge*, the court felt obliged to suppose that the disclaimer disclaimed utility for "particular" purposes only, leaving not disclaimed that the microfilms would have value for some general purposes in connection with interchangeability. This somewhat sophistical interpretation is not required when there are no apparently contradictory clauses to construe. It is therefore, doubtful to say the least that in the absence of a release *Thompson Ramo Wooldridge* would have been any kind of authority here to sustain a claim by Rixon for an equitable adjustment, and still less a breach.

Bidders were also warned that there would be no progress payments until the prototype transmitter was approved, and when it was its cost recoverable by progress payment was limited to $100,000.

The ASBCA found (with support of substantial evidence) that the Navy calculated, on opening plaintiff's bid, that plaintiff would lose approximately $500,000. On the basis of the bid price disparity and the complicated nature of the items to be produced, the procurement officials requested plaintiff to review carefully and verify its cost estimates. It was told that a substantial loss appeared likely, which it would be forced to absorb. The ASBCA found the record unclear, however, as to whether any specific loss figure was mentioned. After checking its cost estimates, plaintiff confirmed its bid price, and the award was made on February 15, 1963.

In *Highway Products Inc.* v. *United States*, 208 Ct. Cl. 926, 530 F. 2d 911 (1976), plaintiff reconfirmed its bid after being warned it was inadequate, and this was held "an unreasonable assumption of risk". Plaintiff here would

distinguish the case in that here the warning was broad and general, while there the procurement officals directed attention to specific components, whose cost and complexity plaintiff had underestimated. There is nothing to show here, however, that Government had more information with which to pinpoint the errors in the bid. The ASBCA found it did not. Plaintiff's charge that it had "superior knowledge" is unwarranted. Such a warning as was given here ought to be enough, and should have been taken seriously. If it is held to be a nullity, future contracting officers will refrain from a courtesy that fairness and decency require.

Six weeks after the award, plaintiff took a step that speaks for itself. It hired a new project engineer (later project manager) with a promised bonus above his salary, of 1% of the contract price if plaintiff made a profit on the contract, *or broke even*. By this date the microfilms had been received and their defects realized, but the new project engineer satisfied himself that the bid "was realistic."

As regards the alleged wrong by the Government that sets up the contractor to be victimized by a coerced release, the invitation to an inexperienced contractor to entangle itself in this briar bush may be deemed morally reprehensible. But it cannot and is not denied that the law allows the Government to do it, if it disclaims any warranty by clear and unambiguous language. Any more effort to deter this contractor from its losing deal would probably have generated accusations that they were trying to preserve the sole source's monopoly. So the question boils down to this: is the disclaimer clear enough, alone or as aided by the warning to check the bid? You can engage a contractor to make snowmen in August, if you spell it out clearly, you are not warranting there will be any subfreezing weather in that month. But if you say you don't represent the microfilms are complete or legible in whole or in any particular part, and that the bid will generate a loss, and the bidder doesn't, apparently, believe you, what more can you say, legitimately, that will be more persuasive? Will you, with reason, conclude that the bidder wants to lose money, or at least, wants to break into this market so badly that loss of money is accepted as a minor consideration?

There is no charge the Government purposely furnished defective microfilm for some sinister object of its own. For all that appears, it did the best it could. It seems a fair inference that the previous sole source alone had the needed know-how. If there is no discrepancy between what defendant furnished and what it warranted it would furnish, the claim that it did wrong is not sustained legally.

The ASBCA further found that shortly after the award, in March 1963, plaintiff's bank reduced its line of credit from $500,000 to $300,000. The Board speculates this may have resulted from credit problems not attributable to the contract, as it is unexplained. It started a plague of financial difficulties that grew worse and worse until finally in December, plaintiff signed the sweeping release here at issue, to get only $50,000 added to its allowable progress payments.

It appears that the main reason for the plaintiff's then parlous economic conditions was its pig-headed resolve to take the contract despite provisions in the invitation amply sufficient to alert it, and despite express warnings that it was going to lose money. The alleged wrong by the Government was either non-existent, or at most a secondary cause. This is what the Board found, it appears with support of substantial evidence. To the extent the drawings were more incomplete and in worse condition than plaintiff might have reasonably expected, the Board assumed its extra costs resulting would have been reimbursable, citing *Thompson Ramo Wooldridge*, erroneously treating the disclaimer provision as substantially the same. Thus it assumes that but for the release, a claim for an equitable adjustment under the Government Furnished Property Clause would have been pursuable. But it does not treat the Government wrong as sufficient to invalidate the release. Seemingly, it would require the wrong to be in the nature of "wrongfully threatened illegal action" or "coercive acts". One gathers that the Board would not consider a past wrong, over and done with, sufficient, even though the resulting shaky financial condition set the contractor up to be a victim of economic coercion. We may assume it is in error about that, but its error simply cancels out its other error about the supposed similarity of the disclaimers to those in *Thompson Ramo Wooldridge*. If, as

we deem likely, contractor's perusal of the IFB and of the microfilms both should have led it not to depend on any help from the latter in achieving interchangeability, the supposed equitable adjustment claim loses its reality. We do not go that far because it is not necessary for present purposes.

It is to be noted, moreover, that plaintiff realized it was in trouble with the microfilms shortly after the award and put its engineers to work on them. By June 24, the work was substantially done, so that only one draftsman was engaged in that endeavor, and the prototype project was considered ahead of schedule. Certain "MCW information" was still missing, but complaint about it was delayed to miss the bid opening for another WRT–1 procurement. This is a highly significant clue as to plaintiff's state of mind. Plaintiff bid $13,950 per unit on this, but did not receive the award. Thereafter it complained openly of missing drawings and documents. It did not say it had any claim for an equitable adjustment for the bad microfilms until long after the date of the release.

Complaints about bad specifications can be waived if not promptly made known to the Government. This was agreed by all tribunals concerned in *Dynalectron Corp.* v. *United States*, 207 Ct. Cl. 349, 518 F. 2d 594 (1975). That was a breach case, the defects being such that production of a satisfactory product was impossible. Here the specifications *per se* were all right and a satisfactory product could be produced by one who followed them. The Government error, if any, was in not communicating its specifications so the contractor could know and follow them. It would seem this is a lesser included wrong and the concept of waiver would be not less applicable. Delay in asserting rights prejudices the Government by running up recoverable costs. *Ling-Temco-Vought Inc.* v. *United States*, 201 Ct. Cl. 135, 475 F. 2d 630 (1973). In a still more recent case, *Highway Products Inc.* v. *United States*, *supra*, there was, as here, a failure by the Government in communicating technical information. Bidding in face of knowledge the technical package was incomplete, and failure to complain promptly afterwards, were major factors in denial of relief to that plaintiff.

These matters add to the difficulty of picturing the plaintiff as the faultless or relatively faultless victim of flagrant Government wrong, the picture that has to be painted to bring the economic duress doctrine into play. It surely cannot be said that plaintiff was so clearly entitled to relief on the microfilm claim that it could not be asked to compromise or trade it off for concessions elsewhere.

2. We now turn to the nature of the compulsion exerted on the plaintiff, allegedly, to force it to give up its microfilm claim. Even if the Government's wrong did cause contractor's financial condition, it loses the benefit of the release only if it used that condition in a coercive manner. The sweeping form of release here involved, was put before the plaintiff in connection with its request to increase the progress payment limitation from $100,000 to $150,000. The Navy advised plaintiff it would be required to pay interest and execute a "pretty tough" contract modification. (We may note again the warning to the contractor, before execution of the contract, that it would lose money on the price it bid, and the loss would lie where it fell. How difficult it is to make such predictions good!) The form of release used was intended "to bring about a disclosure of and circumscribe all present or potential claims before granting relief." This of all times was the time for plaintiff to bring up the microfilm claim, but plaintiff's representatives said nothing about it. The Board quoted and believed testimony that the Navy would have insisted on the release, but would have permitted an express exception for the microfilm claim.

Any claim that release of the microfilm was obtained by economic duress falls flat on its face before these findings. Whatever duress was used to obtain release of any other claim was not used to obtain release of a claim which only needed to be mentioned to be excepted from the release.

The plaintiff's theory in fact implies that these evil Navy officers intentionally used the plaintiff's financial distress to obtain a release of the microfilm claim. Then, however, plaintiff turns to its opposite and inconsistent reformation theory, by which both parties were thinking only of time-delay claims and therefore the release must be reformed to limit it to them alone.

Evidence already mentioned shows that the Navy intended the sweeping language of the release to mean what it said. Only if construed so broadly could it achieve its intended effect of smoking out undivulged claims. As to what the contractor thought it meant, the trial judge says the ASBCA found they thought it meant time-delay claims. He quotes an ASBCA finding as follows:

> * * * Appellant's representatives were disturbed by the text of the release, and feared that it would preclude a defense of excusable delay in the event that liquidated damages for delay were later assessed by the Government. * * *

He conveniently, for his theory, stops the quote there and omits the sentence that follows:

> They were also uneasy as to unforeseen consequences which might result from the comprehensive nature of the release * * *

It is perfectly plain that neither side then thought the release was limited to time-delay issues. It is true, thanks to plaintiff's coyness about the microfilm claim, the Navy was wholly unaware of its existence. But it anticipated that claims undisclosed up to then might be brought out at later dates. The contractor was concerned because it didn't know what it might be releasing. Neither view is consistent with the proposed "reformation", which would alter the release to a meaning not the understanding of either side at the time.

It is true that both sides related the release to release of time-delay claims, which was the only kind of claim they had discussed. The trial judge's fallacy is to suppose, if they thought the release included time-delay claims, they had to have thought it didn't release anything else.

Accordingly, it appears that on the release date plaintiff did not have a clear-cut claim stated, that the microfilm mess was responsible for its troubles. Its coyness about divulging the claim makes it suspect, but at best, it was a highly debatable assertion about matters the Government had tried to warn it against, and had sought to avoid any warranty about. The release was not coerced as to that claim whatever it was worth. It could have been excepted for the asking. The release was intended to be as sweeping and extensive as

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its language. It was so understood by both parties to it. We conclude, therefore, that the ASBCA decision is correct as to result, and it should be affirmed.

Of course we will not be understood as awarding any laurels to the Government for its procurement policy here displayed. It may perhaps be deemed reprehensible to lure a small company into a difficult contract that could only be performed successfully with full Government cooperation as to divulging the details of the technical design, to state in the small print of the IFB that such cooperation is not guaranteed, to withhold it in fact, whether purposely or from inability to do more, and to take advantage of the resultant economic weakness to extract a release for small consideration. The Government can do all this under our decisions, but it is natural that courts will try to rescue the contractor from the consequences of its folly when they think they see their way clear to do so. It therefore becomes difficult to enforce a policy that the loss incurred by the contractor will remain its loss, however stoutly the Government representatives assert it. In this case, however, to shift the loss requires misapprehension of the record and of the decided cases.

Accordingly, the plaintiff's motion for summary judgment is denied. The defendant's motion for summary judgment is granted. The petition is dismissed.

TIMOTHY FRYE v. THE UNITED STATES

[No. 212–75. Decided June 16, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Military pay; retired pay (disability).—Plaintiff enlisted in the Naval Reserve for 6 years; during the period between the date of enlistment and the date he was to be on active duty he suffered a "nervous breakdown" as a result of marital and school difficulties. A Medical Board concluded that plaintiff suffered no disability incident to his service and that his prior disability was not aggravated thereby, and recommended discharge. This determination was concurred in by Physical Evaluation Boards and a Physical Review Council. Plaintiff was honorably discharged by reason of physical

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disability, but was not awarded disability retirement benefits. Subsequently, the Board for Correction of Naval Records denied plaintiff's request for correction of his records to show entitlement to disability retirement. In the present suit plaintiff, agreeing that his mental condition predated his entry into the Navy and was thus not incurred in the service but claiming that it was service aggravated, seeks disability retirement pay. It is *held* that plaintiff has not sustained his burden of proving that the action of the Correction Board was arbitrary, capricious or unsupported by substantial evidence. The evidence before the Correction Board shows that the symptoms of plaintiff's mental problems were essentially the same before and after his 4½ months of naval service, contradicted only by plaintiff's bare assertion that his illness was service aggravated. The analysis made by the Medical Board and confirmed by four subsequent boards constitutes findings of "natural progress" of plaintiff's disorder and effectually conforms with the requirements of Naval Disability Evaluation Manual § 0231. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Military pay; Court of Claims jurisdiction; retired pay (disability) claim.

[1] This court will not interfere with a determination of the military Correction Board that a member was not entitled to disability retirement with pay, unless the decision of the Board was arbitrary, capricious or unsupported by substantial evidence or there was noncompliance with applicable laws and regulations.

Armed Services ⇐⇒ 23.4(1)

Military pay; retired pay (disability); entitlement to disability retired pay; service aggravation.

[2] Where a serviceman's record shows that his claimed disability predated his entry into the Service, absent denial of procedural rights or evidence that his medical examination pursuant to release from service was incomplete or in error, his bare assertion of service aggravation is insufficient to overcome the administrative denial of disability retirement with pay.

Armed Services ⇐⇒ 23.4(1)

Military pay; retired pay (disability); presumptions; service incurrence or aggravation of disability.

[3] An Armed Service is not precluded by statute, regulations or legal precedents from finding that a man's pre-existing medical problem, while not disqualifying him for active service, can be the cause of his release without having been aggravated by the service. Thus, the acceptance by the Service of a man with knowledge of his prior psychiatric history, does not constitute a waiver by the Service of its claim that the condition was wholly pre-existent and not caused or aggravated by military service. The fact that the

Opinion of the Court

man's condition "destabilized" during boot camp (where he performed well) and Corpsmen School does not constitute proof that military service caused the destabilization.

Armed Services ⇐ 23.4(1)

John William Corrington for the plaintiff. *Steven R. Plotkin*, attorney of record.

Alan L. Ferber, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before LARAMORE, *Senior Judge*, DAVIS, and SKELTON, *Judges*.

SKELTON, *Judge*, delivered the opinion of the court:

Plaintiff, in this case, Timothy Frye, enlisted in the United States Naval Reserve on March 14, 1972, for a period of six years. During the period between the date of his enlistment and the date he was to go on active duty, plaintiff suffered a "nervous breakdown" as a result of marital and school difficulties. He was hospitalized for a period of five weeks and received treatment from a private psychiatrist for some two months.

Following this period of hospitalization and treatment, plaintiff still desired to enter the Navy. He was examined by psychiatrists on behalf of the Navy, and they found that his condition had "stabilized" and that he was fit to enter the service. Plaintiff did enter the Navy on October 4, 1972, and performed satisfactorily during basic training.

However, after plaintiff had been in the service some four and one-half months, on February 13, 1973, Naval authorities requested that he be given a physical examination due to his inability to perform adequately in Nursing Lab at the Hospital Corps School. Plaintiff was examined by a Navy psychiatrist, Dr. Howland, and was found to be suffering from a "schizophrenic reaction—acute, undifferentiated type." A Medical Board was convened February 28, 1973, and concluded that "this patient [plaintiff] suffers from no disability which is the result of an incident of service or which was aggravated thereby." The Board found that plaintiff had suffered an illness of psychotic proportions, and there-

fore recommended that he be discharged. The recommendations of this Board, together with a written rebuttal by plaintiff, were forwarded to the Central Physical Evaluation Board, Office of Naval Disability Evaluation, on March 7, 1973. The CPE Board agreed with the prior Medical Board decision and found plaintiff's mental condition "not ratable." On April 3, 1973, plaintiff, accompanied by appointed Government counsel, appeared before the Formal Physical Evaluation Board (FPE Board). After a full hearing, the FPE Board concurred in the previous findings of the Medical Board. On May 21, 1973, plaintiff submitted a written rebuttal to the findings of the FPE Board. On May 25, 1973, the Physical Review Council, in review of the FPE Board record and plaintiff's rebuttal, concurred in the findings of the FPE Board. Based upon this medical evaluation, plaintiff received an honorable discharge from the Naval Service by reason of physical disability on June 26, 1973. He was not awarded disability retirement benefits.

In May 1974, Mr. Frye petitioned the Board for Correction of Naval Records (BCNR) to correct his records to show that he was entitled to disability retirement. After reviewing the opinion of a five member Naval Physical Disability Review Board recommending that plaintiff's records not be changed, and plaintiff's counsel's rebuttal, the BCNR, on December 5, 1974, advised Mr. Frye that his application for correction of Naval records had been denied. Plaintiff filed the instant petition in this court on June 23, 1975.

The case is before the court on plaintiff's motion for summary judgment and defendant's cross-motion for summary judgment. Plaintiff seeks to have this court reverse the decision of the BCNR which refused to correct plaintiff's Naval records to show that he was entitled to disability retirement pay. In order to prevail, plaintiff must prove that the action of the BCNR was arbitrary and capricious or not supported by substantial evidence. In *Kingsley* v. *United States*, 172 Ct. Cl. 549 (1965), we said:

> * * * [B]efore a decision can be made as to whether the plaintiff was in fact physically disabled at the time of his release to inactive duty, there must be a determi-

> nation that the Board did act arbitrarily, capriciously, or without foundation in fact. * * * [*Id.* at 555.]

Furthermore, "[i]t is only where the decision of the board is clearly unsupported by substantial evidence or when there was a noncompliance with applicable laws and regulations, that this court may interfere with the findings of the correction board." *Ward* v. *United States*, 178 Ct. Cl. 210, 216 (1967). Thus, plaintiff's burden is a heavy one, and for the reasons stated below, we hold that he has not met that burden in this case.

Plaintiff does not challenge the correctness of his induction into the Navy, but does contend that there exists a "logical inference that his psychotic episode and its resulting disablement was the result of aggravation of a preexisting condition by Naval service." Plaintiff agrees that his condition did predate his entry into the Navy and was thus not incurred in the service. This leaves proof of service aggravation as the only grounds for plaintiff's eligibility for disability retirement.

In the instant case, there is no question but that plaintiff's mental problems began prior to Naval service for reasons, naturally enough, unconnected to any service with the Navy. Plaintiff in his motion for summary judgment admits that:

> * * * He had serious difficulties with his marriage; he had had difficulties while a student at LSU in New Orleans. He had spent five weeks in the psychiatric facility at Southeastern Louisiana State Hospital.

The evidence before the Board for the Correction of Naval Records shows that the symptoms of plaintiff's mental problems (marital difficulties and school problems) were essentially the same before and after his four and one-half months of Naval service. Furthermore, plaintiff's drug experiences shown by the record certainly cannot be considered to be service related.

The only evidence contrary to the BCNR's finding that plaintiff's illness was not service aggravated is plaintiff's bare assertion that it was. The Physical Evaluation Board found on the basis of the facts before it that plaintiff's illness, first appeared prior to his entry into the service and was quiescent

immediately prior to and during the first four and one-half months of plaintiff's active service, but that it was not aggravated by his Naval service.

Plaintiff has not alleged that he was denied any procedural rights or that his medical examination pursuant to release was incomplete or in error. Plaintiff has not presented any conflicting expert medical evidence. His only grounds for urging reversal of the Naval Board of Correction of Military Records decision are his contentions that his illness was service aggravated, and was presumed to be so by the Navy regulation discussed below, is insufficient to prove the Board's decision was arbitrary and capricious.

Plaintiff's argument that:

> * * * [T]he Navy's acceptance of Frye, with full knowledge of his prior psychiatric history, * * * constitute a waiver on the Navy's part of its later claim that Frye's disabling mental illness was wholly pre-existent, and not caused or aggravated by military service.

is unsupported by either regulation or precedent. In *Kingsley* v. *United States*, *supra*, the Army's acceptance of a man with a history of heart trouble was not in any way held to affect its right to decide that plaintiff was not entitled to disability retirement pay. Clearly no statute, regulation or legal precedent states that an armed service is precluded from finding that a man's pre-existing medical problem, while not disqualifying him for active service, can be the cause of his release without having been aggravated by the service. In the instant case, the record presents "clear and unmistakable" evidence that Mr. Frye's illness existed prior to active service and therefore the standard for overcoming the presumption of sound condition upon entry into service as set forth in *Lipp* v. *United States*, 181 Ct. Cl. 355, 359 (1967) has been met.

As is the case in Army disability retirement regulations, a Navy regulation presumes that an infirmity not incurred in the service but responsible for separation has been service aggravated. *See Bevins* v. *United States*, 166 Ct. Cl. 547 (1964); *Ludzinski* v. *United States*, 154 Ct. Cl. 215 (1961); *Frederick* v. *United States*, 150 Ct. Cl. 769, 280 F. 2d 844 (1960).

The pertinent Navy regulation (Naval Disability Evaluation Manual, § 0231) reads as follows:

* * * * *

> (b) It is further presumed that any additional disability resulting from the pre-existing injury or disease was caused by military service aggravation. Only specific findings of "natural progress" of the pre-existing injury or disease based upon well-established medical principles, as distinguished from medical opinion alone, are sufficient to overcome the presumption of military service aggravation.

The presumption that the disability was aggravated by the service is rebutted by the facts of this case which show that with only four and one-half months of active service after nothing more stressful than boot camp (in which plaintiff performed well) and Corpsmen School, plaintiff suffered a relapse. The mere fact that plaintiff's condition "destabilized" during Navy service does not constitute proof that Naval service caused this destabilization.

The analysis made by the February 28, 1973, Medical Board and confirmed by four subsequent boards constitutes findings of "natural progress" of plaintiff's schizophrenic disorder and effectually conforms with the requirements set forth in Naval Disability Evaluation Manual § 0231.

Furthermore, section 0206 of the Naval Disability Evaluation Manual provides that disease incurred prior to service "will be considered to have been aggravated, when such disability underwent an increase in severity during the service * * *." It is apparent that as shown by the similarity of symptoms and treatment of plaintiff's mental disorder prior to and during Naval service, plaintiff's pre-existing illness did not undergo "an increase in severity during the service."

We find it unnecessary to deal with plaintiff's "Motion to Strike Affidavit," of defendant containing the statement of Commander Stanley J. Kseider. We did not consider the affidavit, and its contents have had no bearing on our decision in this case.

For all the reasons stated above, we deny plaintiff's motion for summary judgment and grant defendant's cross-motion for summary judgment. Plaintiff's petition is dismissed.

Syllabus

536 F. 2d 360

ALBERT C. HOMCY v. THE UNITED STATES

[No. 187-74. Decided June 16, 1976]*

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Military pay; correction of military records; limitation of actions.— On October 19, 1944 plaintiff was convicted by a General Court-Martial of misbehavior before the enemy and was dishonorably discharged on October 5, 1944. During 1947 through 1961 the Board for Correction of Military Records denied plaintiff's numerous requests for correction to show an honorable discharge. In 1968 plaintiff brought a declaratory judgment action in the United States District Court for the District of Columbia seeking correction of his records on the ground that the court-martial lacked jurisdiction; his counsel specifically disavowed any money damage claims, however. The district court granted plaintiff relief on the ground that the court-martial was subject to improper command influence, holding that plaintiff was entitled to have a limited records correction. Subsequently, the General Accounting Office denied plaintiff's claim for back pay. Plaintiff seeks in this court back pay, allowances and other benefits since 1944. It is *held* that since plaintiff received all the relief he requested from the district court and the Correction Board, balancing the policy underlying the statute of limitations, plaintiff may not use the "half-a-loaf" exception to the statute of limitations, (under the "half-a-loaf" exception the Correction Board may not stop short of granting full relief once it grants some favorable relief) to toll the statute of limitations and to secure additional relief. Accordingly, plaintiff's claim is barred by the statute of limitations. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted and the petition is dismissed.

Military pay; limitation of actions; accrual of cause of action; active duty pay; discharge unlawful.

[1] A claim for active duty pay on the ground of illegal discharge from the military service accrues on the date of the member's discharge.

Armed Services ⇐ 23.1(6)

Military pay; limitation of actions; tolling of statute of limitations; Correction Board proceedings.

[2] While pursuit of mandatory administrative remedies will toll the statute of limitations, generally, resort to the Board for Correc-

*On September 14, 1976 plaintiff filed a petition for writ of certiorari.

tion of Military Records is not mandatory and will not toll the statute.

Armed Services ⇐ 23.5

Limitations of actions; purpose of statute.

[3] The statute of limitations is one of finality, designed to protect parties from stale claims after memories have faded, and to bar the possibility of court suits after a reasonable time has passed. A crucial purpose of limitation of actions is to put an opponent on notice in order that he may preserve his defenses.

Limitation of Actions ⇐ 1

Military pay; limitation of actions; continuing claim theory.

[4] Where a military Correction Board in its discretion grants favorable relief to an applicant it may not stop short of granting full relief to him. This is the "half-a-loaf" doctrine which is an exception to the general rule that an applicant's claim for relief arises at the time of improper discharge in military pay cases. Failure of the Board to grant full relief results in a new cause of action or a continuing claim which revives the limitations period.

Armed Services ⇐ 23.5

Military pay; limitation of actions; continuing claim theory.

[5] In order to invoke the "half-a-loaf" doctrine, an applicant for correction of his military records must show that he, in fact, requested full relief from the tribunal and that a discretionary administrative decision has been made to the effect that some relief is proper. The "half-a-loaf" exception to the statute of limitations is not to be read broadly.

Armed Services ⇐ 23.5

Robert H. Reiter, attorney of record for plaintiff. *Spaulding, Reiter & Rose*, of counsel.

Stephen G. Anderson, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before NICHOLS, KUNZIG, and BENNETT, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

In this military pay case plaintiff, a former U.S. Army lieutenant, seeks to recover accrued pay, allowances, and other benefits allegedly denied him from the time of his improper separation from the service in 1944. Because plaintiff's claim is barred by the six-year statute of limitations and has not been revived by recent events, we hold for defendant.

The circumstances of the instant case are extraordinary, if for no other reason than the lapse of time between the underlying events and the initiation of the present suit. On August 27, 1944, plaintiff refused an order from his battalion commander to accompany a war-time patrol in search of enemy tanks. There were extenuating reasons leading to plaintiff's refusal as the men selected to carry out the mission were mostly cooks and orderlies, unqualified to accomplish the mission. However, plaintiff admitted having refused to obey a direct order.

On October 19, 1944, plaintiff was convicted by a General Court Martial of misbehavior before the enemy. He was sentenced to:

> be dismissed [from] the service, to forfeit all pay and allowances due or to become due, and to be confined at hard labor, at such place as the reviewing authority may direct, for fifty (50) years.

The sentence was reduced to ten years but otherwise affirmed by the reviewing authorities.

Plaintiff served fourteen months of the sentence after his dishonorable discharge of December 5, 1944. On January 7, 1946, plaintiff reenlisted in the Army as a private. The Army vacated the remainder of his sentence. Plaintiff received an honorable discharge from this 1946 enlistment on August 24, 1946.

Plaintiff then began his long campaign to have his dishonorable discharge overturned. The Board for Correction of Military Records (BCMR) denied numerous pleas from 1947 until 1961. In 1961 the BCMR granted plaintiff a full hearing, but again, denied his petition. In 1967, allegedly having obtained new evidence, plaintiff renewed his application to the BCMR. The Board denied the petition, this time without a hearing.

Having failed at the BCMR, plaintiff ventured into the district court in search of vindication. He brought a declaratory judgment action in the United States District Court for the District of Columbia seeking: (1) a judgment that the Court Martial lacked jurisdiction and that plaintiff's records should be corrected to show an honorable discharge in 1944; (2) a mandatory injunction ordering the BCMR to correct

plaintiff's records to this effect; and (3) other appropriate relief. Significantly, plaintiff's counsel, in open court in the presence of plaintiff, specifically disavowed any money damage claims in connection with the district court action.

The district court rendered judgment in favor of plaintiff on the ground that the Court Martial was subject to improper command influence. It held that plaintiff was entitled to have a limited records correction.[1] The Court of Appeals (D.C. Cir.) affirmed, solely on the basis of improper command influence. *Homcy* v. *Resor*, 455 F. 2d 1345 (DC. Cir. 1971).

Pursuant to the district court order, the BCMR corrected plaintiff's records to the extent of showing an honorable discharge. It did not grant any monetary relief to plaintiff.

Plaintiff then attempted to gain back pay from the Army Finance Office. The Army referred the claim to the Comptroller General. The General Accounting Office (GAO) denied plaintiff's claim, reasoning that plaintiff received all that he had requested from the district court. Since plaintiff had not petitioned the district court for reversal of his Court Martial, argued the GAO, there was no authority for payment. Plaintiff then proceeded to the district court in an attempt to reopen the prior case and obtain a judgment for back pay. The district court denied the motion on October 12, 1973.

Plaintiff subsequently shifted his efforts to the United States Court of Claims and brought the instant action claiming back pay, allowances and other benefits since 1944.

Plaintiff now enters a motion for summary judgment contending that despite any delay in bringing this action, he is entitled to monetary relief. Plaintiff asserts four bases upon which his claims can be granted without regard to the thirty-year hiatus. (1) The Court of Appeals' opinion established new law, granting plaintiff the right to correction of records *including a mandatory right to compensation.* (2) The BCMR's failure to grant monetary relief provides an inde-

[1] The district court action never overturned plaintiff's Court Martial conviction. Rather, it was directed at his sentence. As stated by the Court of Appeals: "The order of the District Court is affirmed to the extent that it is based on the ground that appellee's court martial sentence was illegal because it was based on improper command influence." [*Homcy, supra,* at 1357].

pendent ground for Court of Claims review, reviving the statute of limitations period. (3) The denial of plaintiff's claims by the Army and the GAO also revives the statute of limitations. (4) The restoration of plaintiff's commission as of 1972 provides a further basis for revival of the time for plaintiff's money damage claims. In short, plaintiff contends that recent events have revived his money damage claims which might otherwise be time-barred.

Defendant counters plaintiff's summary judgment motion with its own cross-motion for summary judgment. According to defendant, plaintiff cannot recover because the claim is: (1) barred by the statute of limitations, (2) precluded by *res judicata*, (3) estopped, or (4) void for lack of legal damages.

We hold that plaintiff's claim is barred by the statute of limitations.[2]

Plaintiff's claim for relief in the Court of Claims initially accrued on the date he was improperly dismissed from the service, December 5, 1944. *Kirby* v. *United States*, 201 Ct. Cl. 527, 531 (1973), *cert. denied*, 417 U.S. 919 (1974); *O'Callahan* v. *United States*, 196 Ct. Cl. 556, 562, 451 F. 2d 1390, 1393 (1971); *Mathis* v. *United States*, 183 Ct. Cl. 145, 147, 391 F. 2d 938–39 (1968), *vacated on other grounds*, 183 Ct. Cl. 150, 394 F. 2d 519 (1968), *petition dismissed*, 190 Ct. Cl. 925, 421 F. 2d 703 (1970). Plaintiff acknowledges this and concedes that any claims in this court based on the illegal discharge have long been barred by the six-year statute of limitations of 28 U.S.C. § 2501 (1970).[3] However, plaintiff

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[2] Since we resolve this case on the statute of limitations issue, we do not reach the questions of *res judicata*, estoppel or legal damages.

[3] 28 U.S.C. § 2501 (1970) provides in part: "Every claim of which the Court of Claims has jurisdiction shall be barred unless the petition thereon is filed within six years after such claim first accrues. * * *" [28 U.S.C. § 2501 (1970)].

Clearly, plaintiff could have brought his claim to the Court of Claims during the six-year period before December 1950 for a resolution of the legality of his Court Martial conviction. He failed to do so and instead pursued permissive remedies before the BCMR. Pursuit of mandatory administrative remedies will toll the statute of limitations. Use of permissive remedies will not. *Friedman* v. *United States*, 159 Ct. Cl. 1, 11–12, 310 F. 2d 381, 387–88 (1962), *cert. denied, Sub nom Lipp* v. *United States*, 373 U.S. 932 (1963). In short, plaintiff's pursuit of permissive remedies did not prevent the statute of limitations from running on his 1944 claim.

argues that recent events have revived his money damage claims. Particularly, plaintiff contends that the refusal of the BCMR, the GAO and the district court to grant him the full relief to which he is entitled, affords him the opportunity to renew his action in the Court of Claims. As plaintiff's counsel conceded at oral argument, plaintiff's entire case rests on our willingness to apply the "half-a-legal-loaf" doctrine enunciated in *Denton* v. *United States*, 204 Ct. Cl. 188 (1974), *cert. denied*, 421 U.S. 963 (1975); *Ray* v. *United States*, 197 Ct. Cl. 1, 453 F. 2d 754 (1972); and *DeBow* v. *United States*, 193 Ct. Cl. 499, 434 F. 2d 1333 (1970), *cert. denied*, 404 U.S. 846 (1971).

Plaintiff is unable to bring his factual situation within the principles of these decisions.

Analysis of plaintiff's "half-a-loaf" argument must begin with consideration of the nature of the statute of limitations and the function of the "half-a-legal-loaf" doctrine as measured against the philosophy of the statute of limitations.

The statute of limitations is one of finality, designed to protect parties from stale claims and bar the possibility of court suits after a reasonable time has passed. *Guaranty Trust Co.* v. *United States*, 304 U.S. 126, 136 (1938). The philosophy of limiting the time for initiation of actions is based on a pragmatic desire to "spare the courts from litigation of stale claims, and the citizen from being put to his defense after memories have faded. * * *" *Chase Securities Corp.* v. *Donaldson*, 325 U.S. 304, 314 (1945), *reh. denied*, 325 U.S. 896 (1945). In addition, a crucial purpose of limitation of actions is to put an opponent on notice in order that he may preserve his defenses. *Hodges* v. *United States*, 125 Ct. Cl. 405, 111 F. Supp. 268 (1953). It is against this background that we consider the "half-a-legal-loaf" doctrine.

The "half-a-loaf" doctrine is an exception to the general rule that a plaintiff's claim for relief arises at the time of improper dismissal in military pay cases. The exception is of fairly longstanding vitality. *See, e.g., Hankins* v. *United States*, 183 Ct. Cl. 32, 34 (1968) and cases cited therein at 34, note 1. Basically it provides that where a Corrections Board in its discretion grants favorable relief to an applicant,

it may not stop short of granting full relief to the applicant. *Denton*, *supra*, 204 Ct. Cl. at 195; *DeBow*, *supra*, 193 Ct. Cl. at 503, 434 F. 2d at 1335. Failure of the Board to grant full relief results in what the court has termed "a new cause of action" or a " 'continuing' claim" which revives the limitation period. As stated by the court in *Denton:*

> * * * [A] claimant can often found a new cause of action, or a 'continuing' claim, upon a [first] favorable determination by the Correction Board * * * where that determination stops short of giving the full relief it was compelled in law to grant *on the presentation then made* * * * [*Denton*, *supra*, 204 Ct. Cl. at 195].

As determined in *DeBow*, the basis for allowing the action despite the statute of limitations problems is that once the administrative body concludes that relief is proper, it is not free to arbitrarily award less relief than requested. *DeBow*, *supra*, 193 Ct. Cl. at 503, 434 F. 2d at 1335; *Sanders* v. *United States*, 207 Ct. Cl. 962 (1975).

The "half-a-loaf" cases reveal that plaintiff must meet two conditions before he may avail himself of the doctrine. First, plaintiff must show that he, in fact, requested full relief from the tribunal. Second, he must show that a discretionary administrative decision has been made to the effect that some relief is proper. Given the public policy favoring the statute of limitations, the "half-a-loaf" exception is not to be read broadly. Therefore, plaintiff must fully demonstrate that he has met *both* conditions to its application. In the case at bar, plaintiff is unable to meet the first condition. We find it unnecessary to decide whether court-ordered administrative action can fulfill the requirement for a discretionary administrative decision.

The district court and the BCMR granted plaintiff the full relief which he requested. Plaintiff has not been denied the "full loaf" because he never asked for it until after the district court granted the right to reversal of the honorable discharge. In fact, plaintiff's counsel at the district court hearing in the presence of plaintiff, specifically disavowed any attempt to seek money damages. Were we to allow plaintiff to revive

his action based on the district court order, we would permit plaintiff to bootstrap his way over the bar of the statute which ran in December 1950.

In a similar situation we were confronted with a plaintiff who had obtained all the relief he had requested from the BCMR and then asked this court to apply the "half-a-legal-loaf" doctrine to grant additional relief. We declined on the basis that failure to request full relief from the BCMR precluded use of the exception to avoid the statute of limitations:

> In these circumstances, it would subvert the functioning of the normal limitations rule for us to allow the plaintiff to skirt the timebar by tying his claim to the favorable Board determination he received upon his representation that he was not asking that tribunal for the very relief he now prays from us. [*DeBow*, *supra*, 193 Ct. Cl. at 503–04, 434 F. 2d at 1335].

The only different factor in the instant case is that plaintiff's alleged partial relief resulted from a district court decree rather than from a BCMR decision to grant relief. This variation cannot change the result. The fact that the district court would have been without jurisdiction to award plaintiff the money damages he now seeks only serves to emphasize the nature of the bootstrap device plaintiff attempts to use, and the fact that plaintiff should have brought an action in this court before December 1950. We cannot hold that plaintiff received "half-a-loaf" from the district court, the BCMR and the GAO when he obtained all that he requested.

In summary, balanced against the policy underlying the statute of limitations, plaintiff may not use the benefit of the "half-a-legal-loaf" exception in the instant case. Plaintiff received the full requested relief and cannot now be heard to assert that he received only "half-a-loaf." Therefore, plaintiff's claim was effectively barred as of 1950 by the normal six-year statute of limitations.

Accordingly, for the reasons stated above, plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted and the petition is dismissed.

Syllabus

536 F. 2d 1354

ATLANTIC NATIONAL BANK v. THE UNITED STATES

[No. 30-75. Decided June 16, 1976]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; Federal tax liens; property subject to lien.—This case involves the priority of Federal tax liens over plaintiff-assignee bank's claims to contract proceeds. In 1973 and early 1974 Argus Security, Inc. was awarded contracts by General Services Administration; by June 4, 1974 the Internal Revenue Service had filed notices of Federal tax liens relating to Argus; on June 5, 1974 as security for loans Argus made assignments to plaintiff-bank of proceeds to be paid under the contracts. Plaintiff claims entitlement to the contract proceeds without reduction or offset, contending (1) that the tax liens did not attach to the contract proceeds when the liens were filed because at that time the monies were not yet earned, and that when earned they were immediately encumbered by plaintiff's security interest; (2) that as to monies earned by Argus on and after June 28, 1974 the Federal Tax Lien Act of 1966 grants plaintiff a priority over earlier filed notices of tax lien as a holder of a security interest within the meaning of Sec. 6323 of the Internal Revenue Code of 1954; (3) that defendant is estopped to claim a lien having priority over plaintiff's rights on the ground that when plaintiff submitted its notices of assignment and the documents to GSA, the latter breached a duty owed to plaintiff in failing to advise it of the tax claims. It is *held* (1) that Argus had a right to, and interest in, the monies due or to become due under the contract, before as well as after the assignments to plaintiff, to enable a Federal tax lien to attach thereto; (2) that plaintiff is not entitled to any priority under Sec. 6323 over the tax liens filed before June 5, 1974; (3) that plaintiff may not recover on its theory of equitable estoppel because it was chargeable with constructive notice of the existence of the tax liens, and accordingly defendant did not breach the duty imposed by *Produce Factors Corp.* v. *United States*, 199 Ct. Cl. 572, 467 F. 2d 1343 (1972); and (4) that the doctrine of marshaling assets is not invocable by plaintiff under the present circumstances. Accordingly defendant prevails on the tax liens which exhaust available funds. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied and the petition is dismissed.

Taxes; liens; property subject to lien.

[1] A Federal tax lien attaches immediately to after-acquired property without any further action required by the Government.

Internal Revenue ⇐ 1717.2

Syllabus

Taxes; liens; property subject to lien.

[2] The fact that the taxpayer's right to contract proceeds was dependent on satisfactory performance does not mean that the proceeds were not property or rights to property of the taxpayer under Sec. 6321 of the Internal Revenue Code of 1954.

Internal Revenue ⇐ 1717.1

Taxes; liens; validity and priority against certain persons; security interest holder.

[3] With relation to Sec. 6323 of the Code, a security interest takes priority over a filed Federal tax lien where (1) the security interest stems from a written agreement which (a) was entered into before the Federal tax lien was filed and (b) qualified as a "commercial transaction financing agreement"; (2) the loans were made pursuant to the written agreement within 45 days after the tax lien filing or prior to receiving actual notice or knowledge that the tax lien had been filed; (3) the written agreement covered "qualified property" which was "acquired" by taxpayer within 45 days of the tax lien filing; (4) state law gives the security interest holder priority over a judgment lien by an unsecured creditor as of the time the Federal tax lien was filed.

Internal Revenue ⇐ 1719.1

Estoppel; estoppel against the Government; tax lien; notice.

[4] To establish an estoppel against the United States, one of the essential requirements is for the party asserting the estoppel to be ignorant of the true facts. Where the Internal Revenue Service had filed notices of tax liens against the contractor and the latter assigned its future contract proceeds to plaintiff-bank and notified the Government thereof pursuant to the requirements of the Assignment of Claims Act, since the purpose of filing a notice of tax lien is to give constructive notice, plaintiff was chargeable therewith and is as much bound by the constructive notice as if it were actual. The Government's duty to "convey" information to an assignee is fully and completely discharged as to tax claims by the filing of tax liens. *Produce Factors Corp.* v. *United States*, 199 Ct. Cl. 572, 467 F. 2d 1343 (1972), *distinguished.*

Estoppel ⇐ 62(2)

United States ⇐ 111(6)

Marshaling of assets and securities; rights of paramount creditor.

[5] The equitable doctrine of marshaling of assets cannot be invoked when to do so would limit the double-fund creditor's ability to satisfy the total debt owed to it. Thus, to the extent defendant is unable to pay itself out of the monies due and unpaid under the subject contracts ahead of plaintiff-assignee bank, defendant will not be reimbursed for the total of the obligations owed to it by the contractor-assignor.

Marshaling Assets and Securities ⇐ 1

H. Joel Weintraub, attorney of record, and *Maurice Steingold*, for plaintiff. *Steingold, Steingold & Friedman, of* counsel.

Leslie H. Wiesenfelder, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before SKELTON, KASHIWA, and BENNETT, *Judges*.

KASHIWA, *Judge*, delivered the opinion of the court:

This case is before the court on cross motions for summary judgment. There is no genuine issue as to any material fact. The case involves the priority of federal tax liens over plaintiff-assignee's claim to contract proceeds. For the reasons below we hold for the defendant.

The General Services Administration (GSA) awarded contracts to Argus Security, Inc. (Argus), for the performance of uniform guard services. By June 4, 1974, the Internal Revenue Service (IRS) had filed Notices of Federal Tax Lien Under Internal Revenue Laws relating to Argus as follows:

Amount of lien	*Date filed with State Corporation Commission, Richmond, Virginia*
$53,870.27	March 21, 1974
32,702.75	June 4, 1974
$86,573.02	

On June 5, 1974, and July 9, 1974, Argus made assignments to plaintiff of proceeds to be paid under its contracts. A more complete chronology of events is listed in the margin.[1] As of

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[1] July 19, 1973—GSA awarded Contract number GS–03B–18175 to Argus.
February 1, 1974—GSA awarded Contract number GS–03B–18245 to Argus.
February 14, 1974—GSA awarded Contract number GS–03B–18244 to Argus.
March 21, 1974—IRS filed a notice of federal tax lien at Norfolk and Richmond, Virginia, for $53,870.27.
May 6, 1974—GSA awarded Contract number GS–03B–18336 to Argus.
May 14, 1974—IRS served a notice of levy on GSA stating that there was due, owing, and unpaid from Argus $60,803.46.
May 16 and June 4, 1974—IRS filed a notice of federal tax lien at Norfolk and Richmond, respectively for $32,702.75.
May 29, 1974—GSA awarded Contract number GS–03B–18385 to Argus.
June 5, 1974—Argus assigned to plaintiff "all monies due or to become due from the United States" under Contract numbers GS–03B–18175, GS–03B–18244, and GS–03B–18245. The assignments contained a warranty that the assignor is not indebted to the United States for taxes and is not otherwise

January 31, 1976, Argus' unpaid tax liability arising out of the two notices of tax lien filed by June 4, 1974, totaled $78,527.93. The total due under the Argus contracts is $43,739.09.[2]

Plaintiff first argues that the tax liens did not attach to the contract proceeds when the liens were filed because at that time the monies were not yet earned. Plaintiff contends that when the monies were earned, they were immediately encumbered by plaintiff's perfected security interest.

Section 6321, Int. Rev. Code of 1954, provides that upon refusal to pay a tax after demand, a lien arises in favor of the United States "upon all property and rights to property, whether real or personal," belonging to the delinquent taxpayer. Argus had a right to, and interest in, the monies due or to become due under the subject contracts to enable a federal tax lien to attach thereto. Even after the assignments to plaintiff, Argus retained a sufficient interest to which a federal tax lien could attach. In *Texas Oil & Gas Corp.* v. *United States*, 466 F. 2d 1040, 1052 (5th Cir. 1972), *cert. denied*, 410 U.S. 929 (1973), the court held:

> * * * a federal tax lien attaches immediately to after-acquired property without any further action required by the Government.

It has also been held that the fact that the taxpayer's right to contract proceeds was dependent on his satisfactory per-

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engaged in a controversy with the United States which might give rise to a claim of a right to set-off.

June 19, 1974—GSA received and acknowledged receipt of three documents entitled "Notice of Assignment."

June 20, 1974—IRS filed a notice of federal tax lien at Norfolk and Richmond for $52,034.22.

July 9, 1974—Argus assigned to plaintiff the monies due under Contract numbers GS–03B–18336 and GS–03B–18385.

July 11, 1974—GSA received and acknowledged receipt of two documents entitled "Notice of Assignment."

July 29, 1974—Effective on this date, the five contracts were terminated by written agreement in accordance with an oral agreement of GSA and Argus on July 26, 1974.

August 2, 1974—IRS served GSA with a notice of levy stating that there was due, owing, and unpaid from Argus $132,422.78.

[2] There is a claim in the total amount of $23,656.98 by the Department of Labor to the withheld funds in suit. However, defendant has stated in its briefs that the court does not have to determine priorities between IRS and the Department of Labor. Since defendant prevails on the IRS claim and the IRS claim exhausts the available funds, we deem it unnecessary to discuss the Department of Labor claim.

formance does not mean that the proceeds were not property or rights to property of the taxpayer under § 6321. In *City of Vermillion* v. *Stan Houston Equipment Co.*, 341 F. Supp. 707, 713 (D. S.D. 1972), the court stated:

> The fact that the taxpayer's right to the proceeds of the contract was dependent upon his performance of the contract and acceptance by the City does not mean that the proceeds were not property or rights to property of the taxpayer under 26 U.S.C.A. Sec. 6321. *Seaboard Surety Co.* v. *United States*, 306 F. 2d 855, 859 (9th Cir. 1962); *Home Ins. Co.* v. *B. B. Rider Corp.*, 212 F. Supp. 457, 462 (D.C.N.J. 1963). The taxpayer had more than a mere contingent right to the proceeds of the contract.

See *Glass City Bank* v. *United States*, 326 U.S. 265 (1945); *Corwin Consultants, Inc.* v. *Interpublic Group of Companies, Inc.*, 375 F. Supp. 186, 193 (S.D. N.Y. 1974), reversed and remanded on another question, 512 F. 2d 605 (2d Cir. 1975); *United States* v. *Blackett*, 220 F. 2d 21 (9th Cir. 1955). Clearly under § 6321 we must hold that plaintiff's argument cannot be sustained.

In *Glass City Bank* v. *United States*, *supra* at 267–69, the Court stated that there "is a plain intent to subject to the lien 'property owned by the delinquent' when suit is filed, rather than only that owned when the lien arose" and also: "Our conclusion is that the lien applies to property owned by the delinquent at any time during the life of the lien. This is in accord with all the cases that have directly passed upon this question." [Footnote omitted.] In *Seaboard Surety Co.* v. *United States*, 306 F. 2d 855 (9th Cir. 1962), the taxpayer was awarded a Government contract on December 31, 1956. On March 2, 1957, a trust agreement was executed assigning the proceeds of the contract to a bank. Prior to the date of the agreement the Government had a fully perfected tax lien on all property and rights to property of the taxpayer. The court stated at 859:

> * * * These tax liens attached immediately to all rights of taxpayer under the government contract awarded December 31, 1956, including payments whenever earned. * * * [T]he trust agreement of March 2, 1957, could not displace the tax liens, which had already attached to taxpayer's property rights in the contract.

> The fact that taxpayer's rights under the contract were dependent upon its performance did not affect the tax liens * * *.

In *United States Fidelity & Guaranty Co.* v. *United States*, 201 Ct. Cl. 1, 475 F. 2d 1377 (1973), this court held that where the IRS was owed taxes by a defaulted prime contractor and the amount was paid to the IRS by the contracting agency out of retained contract funds, the tax lien has priority over a surety that has paid laborers and materialmen on its payment bond. *Accord*, *Seaboard Surety Co.* v. *United States*, 107 Ct. Cl. 34, 67 F. Supp. 969 (1946), *cert. denied*, 330 U.S. 826 (1947).

Plaintiff also relies on § 6323.[3] Plaintiff argues that as to monies earned under these contracts by Argus on and after June 28, 1974, the Federal Tax Lien Act of 1966 grants plain-

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[3] Relevant portions of § 6323 are as follows:

"SEC. 6323. VALIDITY AND PRIORITY AGAINST CERTAIN PERSONS.

"(a) PURCHASES, HOLDERS OF SECURITY INTERESTS, MECHANIC'S LIENORS, AND JUDGMENT LIEN CREDITORS.—The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary or his delegate.

* * * * *

"(c) PROTECTION FOR CERTAIN COMMERCIAL TRANSACTIONS FINANCING AGREEMENTS, ETC.—

"(1) IN GENERAL.—To the extent provided in this subsection, even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing but which—

"(A) is in qualified property covered by the terms of a written agreement entered into before tax lien filing and constituting—

"(i) a commercial transactions financing agreement,

"(ii) a real property construction or improvement financing agreement, or

"(iii) an obligatory disbursement agreement, and

"(B) is protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation.

"(2) COMMERCIAL TRANSACTIONS FINANCING AGREEMENT.—For purposes of this subsection—

"(A) DEFINITION.—The term 'commercial transactions financing agreement' means an agreement (entered into by a person in the course of his trade or business)—

"(i) to make loans to the taxpayer to be secured by commercial financing security acquired by the taxpayer in the ordinary course of his trade or business, or

"(ii) to purchase commercial financing security (other than inventory) acquired by the taxpayer in the ordinary course of his trade or business;

"but such an agreement shall be treated as coming within the term only to the extent that such loan or purchase is made before the 46th day after the date

(Continued)

tiff a priority over earlier filed notices of tax lien as a holder of a security interest within the meaning of § 6323. However, since plaintiff does not in fact qualify for the priority status it claims for itself under § 6323, plaintiff's reliance, based as it is on a fallacious premise, collapses for lack of support.

In *Donald* v. *Madison Industries, Inc.*, 483 F. 2d 837, 842 (10th Cir. 1973), the Court of Appeals in an opinion by Senior Judge Laramore of this court held with relation to § 6323 as follows:

> Summarizing the foregoing definitions and rules as applicable herein, it is apparent that the appellant's security interest will take priority over the filed Federal tax lien if the following requisites are met:
>
> 1. *The "security interest" stems from a written agreement which (a) was entered into before the Federal tax lien was filed*, and (b) qualifies as a "commercial transactions financing agreement" under section 6323(c)(2)(A)(i); [Emphasis supplied.]
>
> 2. The loans were made pursuant to the written agreement within 45 days of the tax lien filing or prior to receiving actual notice or knowledge that the tax lien had been filed, *i.e.*, disbursements or loans after receipt of actual notice or 45 days, whichever is sooner, are unprotected;

(Continued)

of tax lien filing or (if earlier) before the lender or purchaser had actual notice or knowledge of such tax lien filing.

"(B) LIMITATION ON QUALIFIED PROPERTY.—The term 'qualified property', when used with respect to a commercial transactions financing agreement, includes only commercial financing security acquired by the taxpayer before the 46th day after the date of tax lien filing.

"(C) COMMERCIAL FINANCING SECURITY DEFINED.—The term 'commercial financing security' means (i) paper of a kind ordinarily arising in commercial transactions, (ii) accounts receivable, (iii) mortgages on real property, and (iv) inventory.

* * * * *

"(d) 45-DAY PERIOD FOR MAKING DISBURSEMENTS.—Even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing by reason of disbursements made before the 46th day after the date of tax lien filing, or (if earlier) before the person making such disbursements had actual notice or knowledge of tax lien filing, but only if such security interest—

"(1) is in property (A) subject, at the time of tax lien filing, to the lien imposed by section 6321, and (B) covered by the terms of a written agreement entered into before tax lien filing, and

"(2) is protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation."

* * * * *

3. The written agreement covered "qualified property"—here inventory—which was "acquired" by the taxpayer within 45 days of the tax lien filing; and

4. State law gives the security interest holder priority over a judgment lien by an unsecured creditor, as of the time the Federal tax lien is filed.

Accord, 9 MERTEN'S LAW OF FEDERAL INCOME TAXATION § 54.66.7 (1971).[4]

With relation to the four requirements under § 6323, we observe that plaintiff does not overcome the requirement that its security interest arise from a written agreement entered into *before* these tax liens were filed. The first of the written agreements, *i.e.*, the assignments, was executed on June 5, 1974. However, by June 4, 1974, defendant had filed Notices of Tax Lien Under Internal Revenue Law relating to Argus which then totaled $86,573.02. In *Donald* v. *Madison Industries, Inc.*, *supra* at 844, the court held as follows:

> * * * Since these security agreements were entered into *after* the tax lien filing by some eight months or more (one day after would be just as fatal), appellant clearly can draw no support from these documents with respect to the December 1969 tax lien. Section 6323 (c)(1). However, they would be relevant to any tax liens filed after their execution. (Emphasis in original).

Furthermore, plaintiff's position as to its having any priority under the Federal Tax Lien Act of 1966 fails because plaintiff has not demonstrated to this court that its "security interest" at any relevant time became "protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation" as required by § 6323(c)(1)(B). Therefore, we hold that plaintiff is not entitled to any priority under § 6323 over the tax liens filed before June 5, 1974.

Plaintiff also argues that defendant is estopped to claim a lien having priority over plaintiff's rights. It bases its argument on this court's decision in *Produce Factors Corp.* v. *United States*, 199 Ct. Cl. 572, 467 F. 2d 1343 (1972). Plaintiff's position is that when it submitted its notices of the

[4] H.R. Rep. No. 1884, 89th Cong., 2d Sess. 45 (1966), provides as follows in pertinent part:

"* * * Thus, the security interest must arise out of a written agreement entered into before the notice of tax lien was filed * * *."

subject assignments and the assignments themselves to GSA as required by the Assignment of Claims Act, the failure of defendant's officials to advise plaintiff of the tax claims of which GSA had notice was a breach of the duty defendant owed to plaintiff as an assignee. As a result, so the argument goes, plaintiff is entitled to recover the monies it lent to Argus. The language of the *Produce Factors Corp.* decision on which plaintiff relies is as follows:

> The assignee of Government contract rights is, of course, entitled to certain governmental protection of its interests. If at the time it receives notification of an assignment, the Government knows that the assignee's collateral is worthless, the Government must convey that information to the assignee so that he will not advance funds on the strength of proceeds that will never come due. * * * [199 Ct. Cl. at 582, 467 F. 2d at 1349.]

The assignee in *Produce Factors Corp.* was denied any recovery because it failed to establish that the Government had actual or constructive notice of a fact which it was duty bound to convey to the assignee and also because the assignee's knowledge was held to be superior to the Government's.

In order to establish an estoppel against the United States, four separate elements must be present. One of these essential requirements is for the party asserting the estoppel to be "ignorant of the true facts." *Emeco Industries, Inc.* v. *United States*, 202 Ct. Cl. 1006, 1015, 485 F. 2d 652, 657 (1973); *United States* v. *Georgia-Pacific Co.*, 421 F. 2d 92, 96 (9th Cir. 1970). Plaintiff cannot set itself up as being ignorant of the IRS tax claims because it had constructive notice of the existence of said liens.

> * * * The purpose of the filing of a notice of Federal tax lien is to give constructive notice. A purchaser is charged with constructive notice of all a person of ordinary intelligence and diligence would have discovered by an examination of the index to Federal tax liens in the appropriate local office. * * * 9 MERTEN'S LAW OF FEDERAL INCOME TAXATION § 54.66.12 (1971). [Footnotes omitted.]

Accord, *Richter's Loan Co.* v. *United States*, 235 F. 2d 753 (5th Cir. 1956); *United States* v. *Sirico*, 247 F. Supp. 421 (S.D. N.Y. 1965); *Goldstein* v. *Bankers Commercial Corp.*,

152 F. Supp. 856 (S.D. N.Y. 1957), *aff'd per curiam sub nom. Goldstein* v. *United States*, 257 F. 2d 48 (2d Cir. 1958).

Once it is established that plaintiff was chargeable with constructive notice, that notice has the same legal significance as actual notice. In *Simmons Creek Coal Co.* v. *Doran*, 142 U.S. 417, 437 (1892), the Supreme Court stated:

> * * * He is bound not only by *actual*, but also by *constructive* notice, which is the same in its effect as actual notice. * * * [Emphasis in original.]

Accord, 66 C.J.S. *Notice* § 19(b) (1950):

> * * * constructive * * * and actual notice have the same effect, and either constructive notice or actual notice is binding independently of the other. *Accordingly, a person chargeable with constructive * * * notice is as much bound thereby as if the notice were actual.* * * * [Emphasis supplied.] [Footnotes omitted.]

Accordingly, defendant's duty to "convey" information to an assignee is fully and completely discharged as to tax claims by the filing of tax liens. That it would perhaps have been a better course for defendant's officials to give plaintiff actual notice of the IRS claims is not a legally sufficient basis for plaintiff to recover. As a matter of law, defendant did not breach the duty imposed by *Produce Factors Corp.*, *supra*. Plaintiff may not recover, therefore, on its theory of equitable estoppel.

The court need respond only briefly to plaintiff's final contention that the doctrine of marshaling assets should be invoked here to require defendant to collect its claims of offset against assets of Argus being withheld under contracts which are not in issue before this court before defendant can resort to the funds being withheld under the five contracts which are in issue in this case.[5] Defendant states that the total debts owed it by Argus far exceed the total monies defendant is withholding. Thus, to the extent defendant is unable to pay itself out of the $43,739.09 due and unpaid under the subject contracts ahead of plaintiff, defendant will not be reimbursed for the total of the obligations owed

[5] Defendant contends that the doctrine of marshaling assets does not apply to the United States but we need not rule on the question in view of the inadequacy of plaintiff's position.

to it by Argus. There can be no marshaling when to do so would limit the double-fund creditor's ability to satisfy the total debt owed to it. This would be inequitable. *New Bern Oil & Fertilizer Co.* v. *National Bank*, 28 F. 2d 554, 556 (4th Cir. 1928); *Caplinger* v. *Patty*, 398 F. 2d 471, 476 (8th Cir. 1968); *Victor Gruen Associates, Inc.* v. *Glass*, 338 F. 2d 826, 829 (9th Cir. 1964).

CONCLUSION

For the above reasons, defendant's motion for summary judgment is granted, plaintiff's motion for summary judgment is denied, and the petition is dismissed.

BENNETT, *Judge*, with whom SKELTON, *Judge*, joins, concurring:

I concur with Judge Kashiwa's opinion and in the decision reached, but find it necessary to discuss briefly one aspect of plaintiff's rebuttal to the two affirmative defenses set up by defendant in this litigation. When faced with these defenses, plaintiff promptly asserted that its recovery could not be diminished to the extent of its assignor's delinquent taxes or underpaid employee wages, because of the terms of the Assignment of Claims Act of 1940, as amended, 41 U.S.C. § 15 (1970):

> Any contract of * * * the General Services Administration * * * may, in time of war or national emergency proclaimed by the President * * * or by Act or joint resolution of the Congress and until such war or national emergency has been terminated in such manner, provide or be amended without consideration to provide that payments to be made to the assignee of any moneys due or to become due under such contract shall not be subject to reduction or set-off, and if such provision or one to the same general effect has been at any time heretofore or is hereafter included or inserted in any such contract, payments to be made thereafter to an assignee of any moneys due * * * shall not be subject to reduction or set-off for any liability of any nature of the assignor to the United States or any department or agency thereof which arises independently of such contract, * * *.

It should be noted that the statute confers discretion upon contracting agencies to include the appropriate language. A "no set-off" clause is not mandatory.

The record in this case does not include copies of the five contracts themselves which were assigned as security to this plaintiff, nor has plaintiff otherwise proved to my satisfaction that the contracts originally included the no set-off language which is authorized by 41 U.S.C. § 15 (1970). In fact, plaintiff implicitly concedes that no such provision originally appeared in any of the five contracts by arguing in its main brief that the provisions of the Act became operative through an implied contract amendment when it as assignee delivered copies of the assignments themselves to GSA. The instruments of assignments, which we do have before us, contain a warranty running from the assignor to plaintiff that no outstanding claims existed which might result in a set-off, reducing payments otherwise due the contractor.

Thus, plaintiff finds itself reduced to the position that each of these contracts was amended during the course of performance, so as to include by operation of law a provision binding against the Government that payments to be made to the assignee of moneys due or to become due the contractor would not be subject to reduction or set-off for the assignor's liabilities to the United States or its agencies. Plaintiff finds such an amendment implied in fact from the following circumstances: (1) the instruments of assignment to it contained the contractor's warranty that no indebtedness existed in favor of the United States; (2) the instruments were delivered to responsible officials at GSA; and (3) GSA acknowledged receipt of such instruments without exception.

I would go a step further than Judge Kashiwa's opinion and hold as well that, as a matter of law, none of these five contracts were amended to contain a no set-off provision. In order to amend a contract, as in the case of contracting in the first instance, the parties by words or actions must manifest assent to the terms of the proposed bargain. RESTATEMENT, CONTRACTS § 52 (1932); RESTATEMENT, SECOND CONTRACTS § 52 (T.D. No. 1 (1964)). I do not think that we reasonably can say that authorized Government officials manifested their assent to the inclusion of a no set-off provision

in these contracts. The Government did nothing more than to acknowledge receipt of the papers embodying the various assignments. Such an acknowledgment alone on the facts of this case is insufficient to conclude a legally effective amendment of a contract.

I agree that the petition should be dismissed.

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537 F. 2d 417

SOLITRON DEVICES, INC. v. THE UNITED STATES

[No. 133-75. Decided June 16, 1976]

ON DEFENDANT'S MOTION FOR JUDGMENT IN AID OF EXECUTION OF ORDERS OF THE RENEGOTIATION BOARD

Renegotiation of contracts; failure to file bond to stay execution of Renegotiation Board orders; judgment in aid of execution; due process.—In January 1975 the Renegotiation Board entered orders against plaintiff determining that plaintiff realized excessive profits in its fiscal years ended February 28 of 1967, 1968, 1969 and 1970 in stated amounts. Plaintiff petitions for redetermination of its excessive profits, alleging none. However, plaintiff has not filed the required bond to stay execution of the Board's orders. Defendant has counterclaimed for the amounts of the orders and has moved for judgment in aid of execution of said orders. Plaintiff has reargued the statutory scheme of the Renegotiation Act, contending that under the standards established in *Sandnes' Sons, Inc.* v. *United States*, 199 Ct. Cl. 107, 462 F. 2d 1388 (1972), the court should not grant defendant's motion because of plaintiff's mitigating financial circumstances. Plaintiff also contends that the court cannot constitutionally enter judgment according to the statutory scheme without a due process preliminary hearing, and that the right to recover a refund after trial, if the findings establish entitlement, is not enough. The court discusses the changes in legal climate emanating from Supreme Court decisions dealing with "collect now, litigate later" techniques, handed down since *Sandnes'*, and their application to the present case. In view of the fact that plaintiff is a publicly-held company, considered responsible enough to be awarded millions worth of defense contracts over many years, that management had several years from issuance of the statutory notices until the final orders to commence preparations for refund in event of an adverse Board determination, and that plaintiff is not in the present predicament of being unable to obtain a bond without its own fault or negligence, and taking into consideration the changes in legal

Syllabus

climate, the court *affirms* its decision in *Sandnes'*, and *holds* that the statutory procedure is constitutional and that due process is not violated unless enforcement threatens a contractor with substantial injury not reparable by the final judgment obtained after a trial de novo on the merits; and here the possibility of irreparable injury is not a clear and present danger but remote and speculative at the worst. Defendant's motion for judgment in aid of execution is granted, and judgment is entered for defendant in the amounts set forth plus interest as provided by law.

Renegotiation of contracts; pleading and practice; counterclaims; compulsory counterclaim.

[1] Upon the filing in this court of a petition for redetermination of excessive profits under Sec. 108 of the Renegotiation Act of 1951, as amended, and the nonfiling of a bond to stay execution of the order of the Renegotiation Board, the Government's claim for assistance in execution of the Board's order is a compulsory counterclaim under Court of Claims Rule 40(a).

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Renegotiation of contracts; bond to stay execution of order of Renegotiation Board.

[2] The effect of a bond to stay execution of the order of the Renegotiation Board is to stay renegotiation collection by any means, and, absent a bond, collection by any available means, including suits but not limited to suits, is not stayed.

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Renegotiation of contracts; judgment in aid of execution of order of Renegotiation Board; due process.

[3] Recovery by defendant on its motion for judgment in aid of execution of an order of the Renegotiation Board by reason of a contractor's failure, without excusable cause, to file a bond required by 50 U.S.C. § 1218 (Supp. I, 1971) and Court of Claims Rule 26, does not default the contractor or prevent it from continuing to prosecute its Court of Claims litigation with a de novo hearing on the merits. The basis for departing from the statutory procedure on constitutional due process grounds clearly exists only, if at all, when enforcement of that procedure, as written, threatens a contractor with substantial injury which would not be reparable by the final judgment obtained after trial in this court on the merits.

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Seymour Glanzer, attorney of record for plaintiff. *Dickstein, Shapiro & Morin*, of counsel.

Marvin L. Coan, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *John H. Broadley* of counsel.

Opinion of the Court

Before COWEN, *Chief Judge*, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges*, *en banc*.

NICHOLS, *Judge*, delivered the opinion of the court:

We have before us another variation on the theme of the rich but impecunious government contractor who has realized and should refund excessive profits, at least according to orders of the Renegotiation Board, but who cannot stay enforcement of the orders because of inability to obtain a bond. It is one of the paradoxes of our time. We convened an *en banc* court to consider the case because of the possibility we might be obliged to overrule or modify our decision in *Sandnes' Sons, Inc.* v. *United States*, 199 Ct. Cl. 107, 462 F. 2d 1388 (1972). However, we find no occasion to do so. The list of cases involving the same problem also includes *O'Brien Gear & Machine Co.* v. *United States*, 199 Ct. Cl. 1014 (1972); *Bannercraft Clothing Co.* v. *United States*, 207 Ct. Cl. 199, 518 F. 2d 605 (1975); *Manufacturers Service Co.* v. *United States*, 207 Ct. Cl. 185, 518 F. 2d 1202 (1975). This is the first case since *Sandnes'* in which the working of the statute, as constructed in *Sandnes'*, is asserted to violate the Constitution.

Solitron Devices, Inc. (Solitron) is a publicly held company. Its securities are traded on the American Stock Exchange. It is a New York corporation with a principal place of business in Tappan, New York. It is in the electronics business and has several manufacturing facilities, both in this country and abroad. General R. F. Fittings, Inc., was a wholly owned subsidiary but in 1971 became a division of Solitron, and is included in any reference to the parent unless the context indicates otherwise. Solitron, so far as the instant case is concerned was engaged in the manufacture of electronic components such as rectifiers, transistors and diodes. Part of this was defense business, subject to the Renegotiation Act of 1951, as amended, 50 U.S.C. App. Sec. 1211, et seq. (Act), but the correct allocation of sales and costs to such business is in dispute. Solitron does not deny that some at least of its contracts and purchase orders carried the notice prescribed in 50 U.S.C. App. Sec. 1214. It does assert that if the Act were correctly construed and applied to its busi-

ness, it would not be found to have realized any excessive profits as defined in the Act. This, however, involves accounting questions, and matters of judgment, and must be put before our Trial Division on the merits of the case.

The Renegotiation Board commenced renegotiation with respect to Solitron's fiscal years ended February 28, 1967, February 29, 1968 and February 28, 1969 and 1970 (four years) and by orders dated January 24, 1975, determined that Solitron realized excessive profits of $491,112, $1,283,413, $483,451 and $1,460,783 respectively. A separate order assessed General R. F. Fittings for $150,000 for a short year, September 1, 1968 to February 28, 1969. These figures are large reductions from those the Regional Board originally had recommended, so it would appear Solitron was at one time menaced with exactions that greatly exceeded the orders now before us. The figures allow for state taxes but are before adjustment for Federal income taxes.

Solitron has filed its statutory petition in this court to obtain our redetermination of its excessive profits, under the Act Sec. 1218, as amended, alleging it realized no excessive profits. But it has not filed the bond to stay execution of the Board orders. It says it cannot obtain one, or if it could, it would only be by furnishing such collateral that it would be unable to continue business. Defendant has, according to its usual practice, counterclaimed for the amounts of the orders. It has collected a little of them but relatively not much, by other collection measures the Act authorizes. The motion before us now is for judgment in aid of execution. If recovery is had on such a judgment, according to our decision in *Sandnes'*, *supra*, it will not prevent Solitron from continuing to prosecute its litigation here, and if successful, it could of course recover with interest refunds to the extent necessary to effectuate our redetermination.

Solitron realized a renegotiable loss of $4,200,000 in its fiscal 1971, which could not be carried back to the renegotiated years. It paid dividends until the end of its fiscal 1973 year. Its 1971, 1972 and 1973 dividends distributed over $1,000,000. It has repurchased its own debentures. It has invested in real estate. Its working capital February 28, 1975, was $3,761,000 but cash was only $474,000. In Barron's of March 29, 1976, we find its stock listed at 4¼ high, 3⅜ low. We have not attempted to analyze the financial statement furnished in detail.

It seems clear that renegotiation must have been visible as a cloud on the horizon in fiscal 1967, when the first statutory notices started coming in, and the cloud must have grown steadily thereafter. Renegotiation was commenced within two years after the close of each fiscal year. It does not seem that provision was ever made to assure ability to pay renegotiation refunds, if and when determined to be due. Counsel's explanation of this obvious fact is that the company never did believe, and does not now believe, that anything was due. Management clearly must have been aware, a long time before the orders of January 24, 1975, that first the Board staff, then the Regional Board, then the top Board, were of the opinion that something was due. The financial statement (which plaintiff furnished in support of its response) reflects that plaintiff's management is or has been in difficulty with the SEC, and has been sued by investors, because of alleged failure by management to publicize the severity of their renegotiation problems.

Because of economic conditions it may have now come about that bonds to stay renegotiation collection are obtainable only by companies that could pay the proposed refund in cash without inconvenience. And it is clear also that the impact of renegotiation includes not only companies that chose not to prepare for the day of renegotiation reckoning, but also companies that, *e.g.*, by losses in years not under review, never had the ability to pay the refund that appears fair and just from scrutiny of a profitable year or years only.

Counsel have reargued the statutory scheme and we adhere to our exposition of it, that the whole court was agreed on in *Sandnes'*. In brief, by Sec. 1215(b)(1) of the Act, upon the entry of an order the Board may authorize the Service Secretaries to collect by withholding techniques on current payments. Or by Sec. 1215(b)(3) actions may be brought in "the appropriate courts of the United States" to recover from the contractor or persons directed to withhold from him. By Sec. 1218 an entirely different action was authorized to redetermine the excessive profits *de novo*, originally in the Tax Court, now in this. And in that section it is provided that the petition for redetermination stays collection *only* if a bond is timely filed. Thus before we were brought into the picture

by Act of July 1, 1971, Pub. L. 92–41, there were two entirely different court procedures in absence of a bond: to collect, in the District Court, plainly barred from redetermining or reviewing the refund determination itself, as held many times, and to redetermine, in the Tax Court, which had nothing to do with collection except as filing a bond there might stay it. Now that we are the redetermining court, the collection proceeding, in the absence of a bond is a counterclaim which is compulsory here. *See*, also *Manufacturers Service Co., supra.*

Plaintiff notes the stay provision in Sec. 1218 which cross references to Sec. 1215(b) and the "execution of the order of the Board" as the thing stayed. It argues that this means the Sec. 1215(b)(1) withholding procedure. However, suit under Sec. (b)(3) is also "execution" under Sec. 1215(b) and that such suits are "execution" is also shown by the fact that parties ordered to withhold from the contractor under Sec. 1215(b)(1) may also be sued. Plaintiff would reach an absurd result with the effect of the bond apparently being only to stay collection by means other than suits and not to stay suits. The effect of the bond clearly is to stay collection by any means, and by an obvious negative pregnant, with no bond, collection by any available means, including suits but not limited to suits, is not stayed.

Plaintiff then turns to its Constitutional argument. Insisting that in reality it owes nothing, it says we cannot constitutionally enter judgment according to the statutory scheme without some kind of due process preliminary hearing, since there was avowedly none at the Board level. The right to recover a refund after trial, if the findings establish entitlement, it says is not enough. Plaintiff is vague about what kind of preliminary court survey of the case would be sufficient. As a practical matter, in view of the judgmental nature of renegotiation, we think none would. Plaintiff is doubtless really demanding that there should be no collection at all until the processes of this court have been traversed in their entirety and presumably, until the Supreme Court has denied *certiorari.* The administrative process of determining excessive profits is not a speedy one, as this case illustrates. So far the judicial process has, alas, not been particularly speedy either. If plaintiff is right, no one would ever eliminate ex-

cessive profits by agreement. By just refusing to agree, and petitioning to this court, he could probably retain control and use of the alleged excessive profits for nearer two decades than one. If Congress believed that the option to file a bond had become wholly illusory, except for those who could pay without hardship, it might well not vote for plaintiff's procedure. Under the 1943 Act, as we pointed out in *Sandnes'*, *supra*, there was no provision for stay of collection after a final order, by bond or otherwise.

In *Sandnes'*, too, the plaintiff would have had us hold that the procedure we thought the statute required was unconstitutional as to any contractor who was unable to file a bond. A fair reading of our majority and dissenting opinions will show all thought the scheme was not facially unconstitutional. The majority thought it might be unconstitutional as applied to a few exceptional Catch-22 situations, where it might lead to a petitioner being effectively "chilled" in his appeal to this court, without ever having had a due process hearing. The majority wanted to be shown that the contractor had got into its predicament without its own fault or negligence, and further, that the Government would or at least could use the judgment in a manner to prevent further prosecution of the petition in this court. The showing never was made in *Sandnes'*, as the contractor never went before the Trial Division to make it, and this might have been anticipated, for the opportunity to make such a showing was not what it had sought. Three judges in dissent would have entered the requested judgment without further ado, not believing the statutory scheme could be unconstitutional as to any state of facts, or at least any suggested by the record before us.

Should we be satisfied to follow *Sandnes'* as a precedent, we would have to consider the matters we wanted to know more about in *Sandnes'*. Here we know enough to make reference to the Trial Division unnecessary. It is quite apparent that management had nine years, almost, from the time the statutory notices started coming in until the final orders, to commence making preparations for the evil day to come. However unjust they thought the demand would be, prudent management would have suggested some hedge against

it. Management must prepare for the unjust as well as the just exaction. If the notices are not to warn the contractor to prepare for the blow of a Board order, it is difficult to see what purpose Congress meant them to serve. Solitron didn't even stop paying dividends until after 1973. They turned over profits many times exceeding the sums now demanded. Assuming they are now unable to obtain a bond, this would be irrelevant if they could pay the refund and continue in business. They could do this if they had taken the most obvious precautions. They are not, therefore, in the predicament they are in without their own fault or negligence, as at least a contributing cause according to their own showing here.

In *Sandnes'* we directed an inquiry (199 Ct. Cl. at 117, 462 F. 2d at 1394):

> b. Whether plaintiff's financial condition is due in any part to dividends or other distributions made from the notice of commencement of renegotiation, to now.

In *Sandnes'* the contractor was in bankruptcy. In view of this we were also uncertain what if any effect the judgment would have, surmising that like the Board order, it would simply be an item to be proved in the bankruptcy. We directed inquiry as to that point. Plaintiff here is not in bankruptcy and the possibility that our judgment could be used in a destructive way therefore has more plausibility. Plaintiff is not insolvent but we accept at least *arguendo* that if defendant had the judgment it could, if it so willed, put plaintiff in a situation of stringency for cash and working capital, and might make it unable to meet other current liabilities. It would be imprudent for the Government to do so, no doubt, as killing the golden goose, but this does not guarantee it will not do it. It would seem however, if Government really attempted at whatever cost to itself as well as to the contractor, to collect on a liability that our ultimate decision on the merits may wash out entirely, a receivership would be a good defense. Plaintiff's not being in bankruptcy or receivership means its management, so long as this state continues, could dispose of assets while the case was pending here, a factor not present in *Sandnes'*.

Assuming as the majority did in *Sandnes'*, that the statutory scheme may be unconstitutional as it might be applied in a few situations where the judgment in aid of execution would have an exceptionally harsh impact and would "chill" further prosecution of the case on the merits, before any due process hearing thereon, we do not see this as such a case. In some respects, as pointed out, the situation in *Sandnes'* was more suited to give us pause, and to justify a pause for further inquiry. To avert the judgment, therefore, plaintiff must persuade us, contrary to the view of the entire court in *Sandnes'*, that the statutory scheme is facially unconstitutional or at least unconstitutional as applied to every contractor who cannot furnish a bond to stay execution of the Board order. This is Solitron's backup position. It expects us to overrule *Sandnes'* on the basis of changes in the "legal climate", *i.e.*, the atmosphere emanating from Supreme Court decisions dealing with "collect now, litigate later" techniques, handed down since the date of *Sandnes'*, July 14, 1972.

Commissioner v. *Shapiro*, 424 U.S. 614, was decided March 8, 1976, and of course was much discussed in oral argument before us. It shows that "collect now, litigate later" has its limits even in the generally open field of Internal Revenue enforcement. Defendant had assessed taxes on Shapiro and served levies upon various banks in which he had accounts or safe deposit boxes. He was about to be extradited to Israel to be tried for fraud there, and relied on the seized funds to finance his defense and for bail money there. He had a suit pending in the Tax Court which had not been decided. The damage from the seizures would obviously not be repaired by ultimate victory in the Tax Court. The question was whether the Anti-Injunction Act, IRC Sec. 7421(a) barred Shapiro's injunction suit, with the IRS merely asserting there was a tax liability, or whether some inquiry had to be made as to its factual basis. The Government would have required Shapiro to prove there was no factual basis for the tax, not informing him what facts it had. The Court affirmed the D.C. Circuit, holding for Shapiro. The Court said that to allow the Government to seize and hold property merely on a good-faith allegation that a tax was due, would raise

serious Constitutional problems when, as in Shapiro's case, the seizure would cause irreparable injury. *Id* at 627.

These statements are supported by a footnote 11, citing *Goldberg* v. *Kelly*, 397 U.S. 254 (1970); and *Sniadach* v. *Family Finance Corp.*, 395 U.S. 337 (1969), of which we had the benefit in our *Sandnes'* decision, and *North Georgia Finishing, Inc* v. *Di-Chem, Inc.*, 419 U.S. 601 (1975), which has come down since. This latter case holds a Georgia garnishment statute unconstitutional because a writ tying up a banking account may be had at the outset of litigation just by filing a conclusory affidavit and a bond with a clerk of court or other non-judicial officer. The footnote, however, distinguishes *Regional Rail Reorganization Act Cases*, 419 U.S. 102 (1974), where it was held that no probable cause hearing is required where complainant will eventually be made whole for any inadequacy in compensation for confiscated property.

North Georgia Finishing, Inc., supra, likewise distinguishes *Mitchell* v. *W. T. Grant Co.*, 416 U.S. 600 (1974), where a "sequestration" statute passed constitutional muster because there the seller-creditor holding a vendor's lien could obtain the writ only from a judge who had to be satisfied by an affidavit setting forth the facts, beyond mere conclusory allegations There is much debate among the Justices, which need not concern us here, whether *Mitchell* v. *W. T. Grant Co.*, overrules *Fuentes* v. *Shevin*, 407 U.S. 67 (1972), and is in turn overruled by *North Georgia Finishing, Inc., supra.*

Defendant relies on two other recent Supreme Court tax cases interpreting the Anti-Injunction Act, IRC Sec. 7421 (a), that go unmentioned in *Shapiro*, but assuredly are not to be regarded as overruled *sub silentio. In Bob Jones University* v. *Simon*, 416 U.S. 725 (1974), that Act was held to bar a suit to enjoin the IRS from removing plaintiff from the list of tax-exempt private schools. It was asserted that this would cause donors to stop contributing for fear of losing their own tax deductions, an irreparable injury that ultimate victory in the school's own tax litigation would not repair. It was held that the school could not maintain the suit because it could not bring the case within *Enochs* v. *Williams Packing & Navigation Co.*, 370 U.S. 1 (1962), *i.e.*,

it could not show the Government could under no circumstances prevail. *Commissioner* v. *"Americans United" Inc.*, 416 U.S. 752 (1974), followed immediately after *Bob Jones* and involves similar issues. The Court says expressly that irreparable injury does not suffice to bring a case within the *Enochs* v. *Williams Packing & Navigation Co.*, exception, 416 U.S. at 762. We read these cases, with *Shapiro*, as restricting any judge-made exceptions to the Anti-Injunction Act to narrow situations of infrequent occurrence. Here, of course, we have no Anti-Injunction Act and we have legislation of some but not major impact upon the Revenue. The total inability to prevail standard would be difficult to engraft on a Renegotiation case, when so much depends on individual judgment. Of course, any issue, whether a contractor is exempt or otherwise not subject to Renegotiation at all, can here be litigated by summary judgment at the outset of the case, as was done in *Newport News Shipbuilding & Dry Dock Co.* v. *United States*, 208 Ct. Cl. 394, 527 F. 2d 1213 (1975), wherein the contractor got a summary judgment exonerating it from Renegotiation liability for the year involved, on showing that the Board had inadvertently allowed statutory limitations to run before the date of its Order.

It seems fair to say from the recent cases that the indigence of the debtor, and the fact that the contract to be enforced was one of adhesion, have lost some of the importance we assigned to them in our *Sandnes'* discussion. On the other hand, there is no more reason than before to believe that the due process requirements engrafted on the legal remedies of private creditors will be transferred entire to the extraordinary remedies granted the Government in the enforcement of its Revenue Acts and other important monetary legislation. We think an Act is facially constitutional, if it is in that class and if it authorizes a temporary deprivation of property without a hearing, but permits the ultimate making whole of the debtor in case he prevails in the due process hearing ultimately provided. Any exception must be in the instance of some extraordinary hardship as in *Shapiro's* case, irreparable because victory in an ultimate trial manifestly would not make him whole. This is nearly the formula the majority had in mind in the *Sandnes'* case.

We do not wish to be understood, however, as holding that our judgment here will have no better foundation than the garnishment process in Georgia. The Board's orders are at least more than a private creditor's *ipse dixit*, considering the Board's statutory independence (50 U.S.C. App. Sec. 1217), the elaborate procedure it follows according to law and regulations, and its internal appeals, here very successful for the contractor. The order may not have been arrived at by due process in the traditional sense, but contractor was afforded the process which was due in the circumstances, including the availability of a full trial later on. *Cf. Flute* v. *United States*, *ante* at 34, 535 F. 2d 624 (1976).

We can and have read the Board's opinions attached to the petition, and see that they are at least facially reasonable, not bearing the indicia of bias and prejudice, nor appearing the work product of a kangaroo court. Plaintiff asserts bad faith in refusing to consider a Price Waterhouse audit submitted late in the case. The Board explains its position as to this. Whether the audit is decisive for plaintiff of course remains to be determined.

Plaintiff asserts that our function in entering the judgment in aid of execution is ministerial, unworthy of an Article III court. It was performed by District Courts before Pub. L. 92–41, *supra*, albeit with some grumbling. We have necessarily taken the case under our scrutiny to the extent indicated. On the whole, we think our pre-execution judicial scrutiny of the case will stand comparison with that under the Louisiana "sequestration" law, upheld in *Mitchell* v. *W. T. Grant Co.*, *supra*.

Thus we think the basis for departing from the statutory procedure on constitutional due process grounds clearly exists only, if at all, when enforcement of that procedure, as written, threatens a contractor with substantial injury which would not be reparable by the final judgment obtained after trial on the merits. Albeit dictum, here we will say now that *Shapiro* teaches us not to view such instances lightly when their existence is shown. This is not such a case. We are not dealing with the installment buyer of a TV set he cannot afford. We are dealing with a publicly held company, considered responsible enough to be awarded millions worth of defense contracts over many years. Though the long time con-

sumed by the cases before the Board is apparently not unusual, we doubt if Congress contemplated that a contractor would be able to retain alleged excessive profits, interest free, as long as this one has. In the long time taken and given the size, volume, and profitability of the business, it should have been easily possible to prepare for the blow. If plaintiff is in the plight it asserts it is, its own management is largely responsible. Considering the options open to both Government and contractor, the possibility of irreparable injury is not a clear and present danger, as in *Shapiro's* case, but remote and speculative at the worst. Plaintiff may be concerned how the judgment will be received by the SEC and by its investor plaintiffs, but they all can read this opinion and see there is not a final judgment here on the merits. If collection from plaintiff is effected, it may recover everything on final judgment, with interest as provided by law. There is no clear and convincing demonstration that this will not make it whole.

Accordingly, defendant's motion for judgment in aid of execution is granted. The tax credit computations furnished by the Internal Revenue Service must be used. If they are wrong, this can be corrected in the final judgment. Judgment is entered for defendant in the following amounts with interest as provided by law:

Fiscal Year:	
1967	$491,112.00
1968	1,283,413.00
1969	483,451.00
1970	1,460,783.00
For General R. F. Fittings	150,000.00
Less tax credits as follows:	
Fiscal Year:	
1967	$235,733.76
1968	None
1969	None
1970	Not known: Defendant stipulates maximum possible, 48%.
For General R. F. Fittings	None

Concurring Opinion by Judge Bennett

Net after tax credit:

Fiscal Year:

1967	$255,378.24
1968	1,283,413.00
1969	483,451.00
1970	759,607.16
For General R. F. Fittings	150,000.00

BENNETT, *Judge*, joined by KUNZIG, *Judge*, concurring: I concur in the result and in the court's opinion so far as it goes, but feel it necessary to add a few words because the majority opinion does not squarely address one of the two constitutional defenses asserted by plaintiff to defendant's motion for summary judgment in aid of execution of the orders of the Renegotiation Board entered against plaintiff.

Plaintiff correctly observes that the U.S. Court of Claims is a court created under article III of the Constitution. *Glidden Co.* v. *Zdanok*, 370 U.S. 530, 571–84 (1962). Plaintiff then refers us to article III, section 2, of the Constitution. Section 2 provides that the federal judicial power extends to all "cases and controversies" to which the United States shall be a party. But, plaintiff says that pre-hearing entry of a money judgment by this court based not upon facts and evidence, but solely upon the board's orders, would not be an act of a sufficiently judicial nature to be performed by an article III court. In other words, such a judgment would be *void* since not produced by an exercise of the judicial power of the United States. Plaintiff views the renegotiation statute as attempting to vest in the judiciary jurisdiction over matters which are purely legislative or administrative in their substance when in section 108 it would authorize issuance of pre-redetermination "judgments" in aid of execution of administrative orders. Plaintiff says that this is just not adjudication by the court of a justiciable controversy. This particular question has not heretofore been squarely addressed in a majority opinion of this court in renegotiation cases. I think we must now speak to it. Of course, it is not contested that legislative or administrative jurisdiction cannot be conferred upon article III courts. To do so would

violate the doctrine of the separation of powers. The question now is whether or not that is what Congress has done here.

Plaintiff asserts that for us to enter a $2.9 million judgment against it without evidence upon which we can exercise the judicial power of the United States, indeed lacking even an administrative record, and in face of the policy of the Renegotiation Act that no presumptive validity attaches to the unilateral declarations of the Renegotiation Board, simply makes the court a rubber stamp for the board and transforms the court into an extention of the administrative processes of the executive branch. Alternatively, plaintiff suggests that if section 108 of the Act requires this court to enter a judgment on behalf of defendant in such a factual void, that section should be held to be unconstitutional "as it is patently antithetical to the concept of justiciability embodied in Article III of the Constitution." On justiciability generally, see *Baker* v. *Carr*, 369 U.S. 186 (1962).

Plaintiff's constitutional arguments are serious and twofold. First, that to go along with defendant's demand for judgment because plaintiff has not posted the required bond would be premature and deny plaintiff due process if there is no hearing on that issue, or indeed upon all the issues presented by the pleadings. The court's opinion deals adequately with plaintiff's due process issue as it pertains to a demand for hearing before judgment in aid of execution of the board's orders. The second issue, however, which the opinion does not address, is whether the judicial power of the United States attaches at all in the present posture of the case.

We have here a peculiar statute that requires a contractor "to pay now and litigate later." But, it does provide plaintiff with the opportunity, in a de novo hearing at a later date, to show, on the merits, that the board determination was wrong and to recapture, with interest, any sums wrongly found by the board to have been excessive profits. It is in the present initial stage of the case that we have this ancillary proceeding with reference to stay of execution. As defendant suggests, this is the time for the court to inquire into whether the board's orders were entered against the proper party, whether the procedures followed in entering the board orders were lawful, whether plaintiff has paid the amount

claimed by the board to be due, whether it has in fact posted the required bond to stay execution, and whether the entry of a judgment now would have a chilling effect on plaintiff's ability to litigate the de novo redetermination. The court has no problems with these factors in this case. It adheres to its prior holdings that section 108 requires the posting of a bond as a condition for stay of the orders of the Renegotiation Board and that the court is required and directed to grant a judgment in aid of execution based on those orders when no proper bond is filed without excusable cause.

As to the jurisdictional issue, this proceeding involves a justiciable case or controversy to the extent it seeks, and defendant opposes a judicial determination of the ultimate issue of excessiveness. The ancillary or collateral relief now being sought—judgment in aid of execution of the board's orders—could not be awarded in the absence of plaintiff's own petition for redetermination. We would have no jurisdiction absent an affirmative claim for relief. In order words, plaintiff brought us a case or controversy when it filed its petition. We do not decide the merits thereof at this stage, but under the statute must go forward as it directs without prejudice to plaintiff's right and opportunity to prove to us that the board was wrong and that its profits were not excessive. The judicial power has been invoked. Yes, it is hard to have to put up the money first and litigate later. But, this statutory scheme was on the books when plaintiff took the contract with notice of it. By entering renegotiable business and by failing to provide the bond the statute requires, plaintiff, in my view, has waived the right to any hearing on the merits of the excessiveness issue prior to execution of the board's orders. Also, the Supreme Court has sanctioned the constitutionality of the pay now, litigate later scheme in upholding unilateral revenue determinations similar to the scheme in the Renegotiation Act, where adequate opportunity is afforded for a later judicial determination of the legal rights. *Phillips* v. *Commissioner*, 283 U.S. 589, 593–95 (1931). Of course, there is room for argument that the basic purpose of the Renegotiation Act is not to gather revenue, if that makes any difference, which I think not. *Sandnes' Sons, Inc.* v. *United States*, 199 Ct. Cl. 107, 462 F. 2d 1388 (1972). But,

Syllabus

plaintiff cannot complain when it has not convinced the court that it cannot put up the bond to stay execution. *Cooper MacDonald, Inc.* v. *United States*, 207 Ct. Cl. 1036 (1975); *O'Brien Gear & Machine Co.* v. *United States*, 199 Ct. Cl. 1014 (1972). Hardship entailed by the bond requirement is insufficient excuse, without more, for noncompliance. Nor can it properly claim that we are not proceeding with a case or controversy under article III when it has given us just that which it now says is lacking, and we are only proceeding in an ancillary, collateral way without prejudice to the merits of plaintiff's principal claim.

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536 F. 2d 365

EUGENE COOK AND RUTH S. COOK (CO-EXECUTORS) v. THE UNITED STATES

[No. 348–74. Decided June 16, 1976]

ON PLAINTIFFS' AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Civilian pay; involuntary retirement; medical disability.—Plaintiffs, executors of the estate of decedent Kenneth S. Cook formerly employed in a civilian capacity at Holloman Air Force Base, seek back pay claiming that the involuntary retirement procedures followed by defendant violated Cook's constitutional rights to due process and free speech, and that they contravened certain statutes and regulations. Due to the nature of letters Cook wrote criticizing his superior, he underwent certain medical examinations resulting in the convening of a Medical Board which concluded that Cook suffered from a "paranoid personality pattern" and suggested that he be retired for medical reasons. The Director of Base Medical Services approved the Board's findings despite Cook's submission of additional reports from doctors and character references, and involuntary retirement proceedings were instituted. After the requisite administrative determinations and appeals, Cook was involuntarily retired. It is *held* that the Medical Board was properly constituted, Cook received adequate notice of the Board proceedings, there was no violation of regulations or constitutional rights in denying Cook the right to counsel or cross-examination at the Board sessions, the action did not constitute retaliation or an attempt to deny Cook his right to free speech, and there was no administrative abuse of discretion. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted and the petition is dismissed.

Syllabus

Civilian pay; Medical Board; convening of.

[1] The convening of an Air Force Medical Board to consider the physical and/or mental condition of a civilian employee is not, in and of itself, an adverse action. Air Force Regulations provide no specific notice requirement for Medical Board determinations; the 30-day notice requirement of AFR 40–752, ¶ 5(a) refers to a proposed Civil Service Commission adverse action and not Medical Board proceedings.

Armed Services ⇐ 27

Civilian pay; Medical Boards; right to counsel and to cross-examine witnesses.

[2] The failure of the Air Force to provide a civilian employee with counsel and an opportunity to cross-examine witnesses before a Medical Board considering the employee's physical and/or mental condition, does not violate the latter's procedural rights. AFM 168–4, ¶ 16–5b which governs Medical Board proceedings and which provides that the "principles" of AFR 11–1 relating to the general conduct of civil service personnel investigations are to be considered in the conduct of Medical Boards, is permissive, not mandatory.

Attorney and Client ⇐ 23

Constitutional law; due process of law; Medical Board proceedings.

[3] The failure of the Air Force to provide a civilian employee with counsel and an opportunity to cross-examine witnesses before a Medical Board which considered the employee's mental condition and which suggested that he be retired for medical reasons, is not violative of the constitutional right to due process where the employee had available and used a wide range of remedies in subsequent administrative proceedings.

Constitutional Law ⇐ 318(2)

Civilian pay; presumptions; official actions of Government officials.

[4] There is a presumption that Government officials act in good faith, and absent evidence in the record that plaintiff's involuntary retirement was based on the agency's desire to retaliate for his exercise of free speech, the presumption is not overcome.

Armed Services ⇐ 27

Civilian pay; Court of Claims jurisdiction; administrative or executive decisions; review of by court.

[5] Where the court concludes that the determination by the Medical Board of plaintiff's physical disability is based upon substantial evidence, the court is not free to substitute its judgment for that of the Board, particularly where medical questions are involved.

Armed Services ⇐ 27

James M. McHale, attorney of record for plaintiff.

Marc J. Fink, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

214-954—77——26

Opinion of the Court

Before COWEN, *Chief Judge*, DAVIS, and KUNZIG, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

In this civilian pay case plaintiffs, executors of the estate of Kenneth S. Cook, formerly employed as an Operations Research Analyst at Holloman Air Force Base, sue for Cook's back pay. In 1967, Cook was involuntarily retired from his position for mental disability. Plaintiffs bring the instant action to invalidate the retirement.

The gravamen of the complaint is that the involuntary retirement procedures followed by defendant violated Cook's constitutional rights to due process and free speech. Plaintiffs also say that the procedures contravened certain statutes and regulations. We find that the procedures comported with all legal requirements and, therefore, hold for defendant.

The problem which eventually culminated in Cook's retirement began with submission of three letters to the Commander, Office of Aerospace Research (OAR). In these letters Cook criticized the performance of his immediate superior, a LTC Clarke. The letters contained several cartoon-type drawings. The OAR responded by advising Cook to settle any disputes within the grievance system provided by the Air Force. The OAR also sent copies of Cook's letters to Clarke.

In December 1966 and January 1967, Cook underwent medical examination. The examining surgeon found no evidence of disability. Nor did the psychiatrist. However, a consulting psychologist described Cook as a "psychotic personality with paranoid tendencies." The psychologist recommended withdrawal of Cook's security clearance, coupled with a change in duty assignment. As a result, Holloman convened a Medical Board to consider Cook's case. The Board interviewed both Clarke and Cook. It ordered additional examinations which proved negative. However, the Board concluded that Cook suffered from a "paranoid personality pattern" and suggested that he be retired for medical reasons.

The Director of Base Medical Services approved the Board's findings despite Cook's submission of additional reports from two doctors and several character references.

On May 16, 1967, the Base instituted involuntary retirement proceedings against Cook. After the requisite administrative determinations and appeals Cook was involuntarily retired. Cook then took his case to the United States District Court for the District of Columbia. Judge William B. Jones (now Chief Judge) granted the Government's motion for summary judgment. Cook died during the pendency of an appeal to the D.C. Circuit and the case was dismissed as moot without prejudice to the executors to bring an appropriate action in this court.

Plaintiffs' motion for summary judgment seeks a determination that Cook's involuntary retirement proceedings were invalid. The attack centers on the proceedings before the Medical Board at Holloman Air Force Base. Plaintiffs say that there is sufficient error in the administrative determinations to reverse the actions taken by the CSC and the Air Force. The atmosphere of reprisal against Cook, the failure to consider evidence favorable to him, and the use of "tainted evidence" all distort the pattern of the retirement process, plaintiffs contend.

Specifically, plaintiffs contest: (1) the composition of the Medical Board, (2) the adequacy of notice given to Cook of the adverse proceedings, (3) defendant's failure to afford Cook the right to counsel and cross-examination at the Board hearings, (4) the effect on Cook's free speech right caused by defendant's actions against Cook and (5) the CSC's arbitrary misuse of its discretion.

Upon review of the motions, briefs and pleadings, in addition to the CSC record, we find no reversible error in the involuntary retirement proceedings. We, therefore, deny plaintiff's motion for summary judgment and grant defendant's cross-motion.

First, the Medical Board of which plaintiffs complain, was properly constituted. Plaintiffs say the Board was invalid because it included a consulting psychologist who was not a Medical Corps officer. The Air Force Manual 168-4(b) provides in part:

> Appropriate Members. Regulations require that personnel appointed to a medical board will be "medical officers." *This term includes medical officers.* * * * *and appointed consultants.* * * *

As a consulting psychologist at Holloman AFB, the Medical Board member of which plaintiffs complain was correctly appointed under the regulations. The Board included no unqualified officers.

Second, plaintiff properly received all notice required by the Regulations precedent to the adverse action against him. Air Force Regulation 40–752, ¶ 5(a), specifically provides notice requirements:

> The date of the medical determination must be not more than 30 days before the date of the notice of the proposed adverse action.

Plaintiffs confuse the functions of the Medical Board and the CSC. The purpose of the Board is to evaluate plaintiff's condition and make recommendations to the Air Force. The convening of the Board is not, in and of itself, an adverse action. The adverse action is the involuntary retirement proceeding before the CSC. Plaintiffs do not allege that Cook failed to receive proper notice of the CSC proceedings. Instead, they complain that no written notice was given to plaintiff prior to the Medical Board sessions. However, the Regulations provide no specific notice requirement for Board determinations. Plaintiffs would transpose the 30 day requirement to the Medical Board setting but there is no authority for this. Even if some form of notice is required, the record shows that Cook must have received it for he did appear before the Board. In short, plaintiffs fail to demonstrate that defendant violated notice requirements.

Third, defendant violated no procedural rights guaranteed to Cook by failing to provide counsel and an opportunity to cross-examine Board witnesses. Plaintiffs argue that the refusal to grant Cook his right to counsel and cross-examination violated both regulations and the Constitution. Once again plaintiffs would confuse the nature of the Medical Board determination with the CSC action.

Defendant's conduct did not violate the Regulations. AFR 11–1 governs the general conduct of personnel investigations. It provides for notification of the right to counsel and cross-examination. Plaintiffs say that this Regulation *must* be applied to Medical Board proceedings. However, AFM 168–4, ¶ 16–5b governs such requirements. It states that the "princi-

ples" of AFR 11–1 are to be considered in the conduct of Medical Boards. It is permissive, not mandatory. Defendant did not violate any regulations by failing to provide Cook with the right to counsel or the opportunity to cross-examine witnesses at the Board hearing.

Moreover, the failure to grant Cook these rights did not violate any Constitutional right to due process. It is axiomatic that due process guarantees no particular form of procedures. *See, e.g., Mitchell* v. *W. T. Grant Co.*, 416 U.S. 600, 610 (1974).

> The types of "liberty" and "property" protected by the Due Process Clause vary widely, and what may be required under that Clause in dealing with one set of interests which it protects may not be required in dealing with another set of interests. [*Arnett* v. *Kennedy*, 416 U.S. 134, 155 (1974)].

In the instant case, both Cook and the Government had an identical interest in the accuracy, completeness and quality of the medical evidence presented to the Board. In sharp contrast, Cook had available and used a wide range of administrative remedies, after the Medical Board determination. Due to the exhaustive nature of these subsequent proceedings, we cannot say that a denial of trial-type safeguards at the Board constituted a denial of Cook's due process rights. *See Arnett, supra*, separate opinion of Powell and Blackmun, JJ. at 168–71; *Scroggins* v. *United States*, 184 Ct. Cl. 530, 534, 397 F. 2d 295, 298 (1968), *cert. denied*, 393 U.S. 952 (1968).

Fourth, the facts of the instant action do not show that defendant's involuntary retirement of Cook was based on a desire to retaliate against him for the letters or to "chill" his Constitutional right to free speech. As defendant properly indicates, there is a presumption that Government officials act in good faith. *See, e.g. McGlasson* v. *United States*, 184 Ct. Cl. 542, 550, 397 F. 2d 303, 307 (1968). Plaintiffs point to nothing in the record which would overcome this presumption. We are asked to infer an atmosphere of reprisal from a withholding of Cook's security clearance, the denial of a salary increase and the initiation of Medical Board proceedings. The inference, if any, fails to overcome the pre-

sumption. Indeed, examination of the record finds that the lone concern of the Government was Cook's health, not his desire to exercise his right to free speech. Defendant's involuntary retirement of Cook cannot be held to constitute a pretext to retaliate against him or to deny his Constitutional rights.

Finally, there is nothing in the record which points to an abuse of discretion in the administrative determination of Cook's disability. Plaintiffs say that the *CSC's* failure to investigate the "substantial accusations (or retaliation)" or to provide the opportunity for evidence to be presented at a hearing, constitutes an arbitrary abuse of discretion. Plaintiffs also attack the *Medical Board's* refusal to consider favorable medical reports and the use of "tainted evidence." However, based upon the record, the administrative determinations appear to have been correct.

The *CSC* properly confined its considerations to evaluation of Cook's disability. It followed all necessary procedures in concluding that Cook should be retired for disability. Given the substantial evidence of Cook's condition and the fact that the CSC found Cook should be retired for disability, there was no need for a further evidentiary hearing on the issue of free speech retaliation.

Nor did the *Medical Board* deliberations show any demonstrable impropriety. The Board considered evidence both favorable and unfavorable to Cook and recommended retirement. There appears in the Medical Board's record, substantial evidence of Cook's disability. Given such substantial evidence, we are not free to substitute our own judgment for that of the Board, particularly where medical questions are involved. *Cf. Scroggins*, *supra*, 184 Ct. Cl. at 537, 397 F. 2d at 299.

Plaintiffs fail to support their allegation of administrative abuse of discretion.

In summary, based on the facts of the instant case, we find no reversible error in defendant's involuntary retirement of Cook for medical disability. The Medical Board was properly constituted, Cook received adequate notice of the Board proceedings, there was no violation of regulations or Constitutional rights in denying Cook the right to counsel or cross-examination at the Board sessions, the action did not

Syllabus

constitute retaliation or an attempt to deny Cook his right to free speech, and there was no administrative abuse of discretion. In short, plaintiffs demonstrate no impropriety in the proceedings.

Accordingly, for the reasons stated above, plaintiffs' motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted and the petition is dismissed.

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537 F. 2d 426

FIRST NATIONAL CITY BANK v. THE UNITED STATES

[No. 9-75. Decided June 16, 1976]*

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; Assignment of Claims Act; beneficiary of refinancing transaction; subrogee of assignee; Government set-off rights.—In 1966 Trilon Research Corp. entered into a contract to prepare and update Navy technical manuals for $87,318.46, the contract incorporating by reference § 7.103-8 of the Armed Services Procurement Regulations relating to assignment of claims. Pursuant thereto Trilon, Franklin National Bank and the Small Business Administration entered into an arrangement whereby Trilon obtained a loan of $250,000, half from Franklin (as trustee) and half from SBA. Both parties took a lien on Trilon's inventory and receivables and obtained an assignment of Trilon's right to Government contract payments, including but not limited to the contract here in issue. By completion of the contract in November 1968, defendant had made progress payment of $46,527.43 to Trilon and had paid Franklin (as trustee) the remaining $40,791.03. A year later plaintiff began making loans to financially troubled Trilon, the initial loan being in excess of $250,000. In September 1969 SBA advised Franklin that it had agreed to subordinate its one-half interest in Trilon's inventory and receivables, including Trilon's Government contracts, to plaintiff. Subsequently plaintiff loaned Trilon additional sums and is now owed more than $400,000. In September 1971 Franklin "called" its loans to Trilon and threatened to call SBA's loan. Attempting to forestall this action, Trilon issued a $45,000 check payable to Franklin and drawn on plaintiff. Based on independent loans to Trilon, plaintiff held a prior right to this amount. To permit Trilon to continue work on ongoing Government contracts, Franklin and plaintiff entered into a refinancing

* On defendant's motion for rehearing *en banc*, this opinion was vacated and a new discussion and decision was substituted. *See* 212 Ct. Cl. ____, 548 F. 2d 928.

Syllabus

arrangement whereby Franklin transferred to plaintiff its security interests in Trilon's receivables (including Government contract rights). Plaintiff paid Franklin $52,812 representing Franklin's remaining risk on the $125,000 loan by releasing its priority rights to the $45,000 check and paying Franklin the balance of $7,812 in cash. Trilon executed a second "notice of assignment" of the subject contract (which was sent to defendant), and assigned the payment rights to plaintiff. Defendant neither rejected nor accepted the notice but remitted the documents to plaintiff to obtain a release of Trilon's prior assignment to Franklin. As a result of an ongoing dispute over Trilon's entitlement to additional compensation on the subject contract, Trilon and defendant ultimately agreed that Trilon had earned an additional $62,181.37. Plaintiff's right to receive this latter sum was contested by defendant who claimed that it had sufficient set-offs to obliterate plaintiff's entitlement to the award. Plaintiff claimed that the subject contract contained set-off protection enabling it, as assignee, to receive said sum, free of set-off claims. The Comptroller General held that plaintiff could recover $7,812 free of set-off, but disallowed the balance of $54,379.32. Plaintiff seeks to recover the latter sum plus interest, free of set-off, claiming it has standing to sue as (1) the real party in interest, (2) beneficiary of the 1967 assignment, (3) subrogee of Franklin's interests, or (4) legal assignee under the Assignment of Claims Act based on Trilon's 1971 reassignment. It is *held* that plaintiff has standing to use the set-off protection provisions of the Assignment of Claims Act, the ASPRs and the contract because it may sue on the contract either as beneficiary of the 1971 refinancing transaction or as subrogee of the original contract assignee; that plaintiff's entitlement to the set-off protections extends to encompass the entire $54,369.37, because it has effectively participated in the financing of Government contracts; and that the court's construction of the Act is in complete accord with the intent of Congress to promote financing of Government contracts. Plaintiff's motion for summary judgment is granted in part and denied in part (as to the interest issue) and defendant's cross-motion is denied. Plaintiff is entitled to recover $54,369.37 free of set-offs and judgment is entered to that effect. The interest issue is remanded to the Trial Division for further proceedings consistent with the opinion.

Contracts; Assignment of Claims Act; set-off, Government right of; legislative intent.

[1] The 1951 amendment to the Assignment of Claims Act broadening the Government contract set-off protection afforded banks, trust companies or other financing institutions, demonstrates the intent of Congress to have the Act's 1940 amendments broadly, not narrowly, construed in order to encourage financing of Government contracts.

United States ⇐ 111(2)

Syllabus

Contracts; assignment of claims; Armed Services Procurement Regulations.

[2] Drafted with reference to the Assignment of Claims Act, § 7.103–8 of the Armed Services Procurement Regulations permits not only assignment and reassignment in certain instances, but grants set-off protection to assignees.

United States ⟸ 111(2)

Contracts; assignment of claims; assignment to party as trustee for parties participating in financing; validity of assignment; reassignee-bank as beneficiary; standing to sue.

[3] Where bank F (as trustee) and the Small Business Administration (SBA) loaned T money to finance performance under T's Government contract, taking a lien on T's inventory and receivables as well as an assignment of T's right to Government contract proceeds, and where F, after reassigning to plaintiff-bank CB the equitable right to receive contract proceeds, continued to hold the legal right to said proceeds as trustee, the beneficial interest in the contract passed to CB. The Assignment of Claims Act and applicable ASPRs were not violated, since F, a single party, continued to act as trustee for CB and the SBA. Since CB meets the conditions to valid assignment imposed by the Act and ASPRs, it has standing to maintain the present action as beneficiary of T's assignment.

United States ⟸ 111(10)

Contracts; subrogation; generally.

[4] Generally, subrogation applies where a party not acting voluntarily, but under some compulsion pays a debt or discharges an obligation for which another is primarily liable and which in equity and good conscience ought to be discharged by the latter. In such circumstances, the subrogee stands in the place of the original creditor and obtains equivalent but no greater rights against the debtor than held by the original creditor.

Subrogation ⟸ 1

Contracts; subrogation; assignment to party as trustee for parties participating in financing; reassignee-bank as subrogee; standing to sue.

[5] Where the court has determined that the instant case meets the conditions to valid assignment imposed by the Assignment of Claims Act and the ASPRs in that the contract called for payments in excess of $1000, reassignee-plaintiff CB is a bank which advanced funds to original assignee bank F which continued to act as sole legal assignee, and CB participated in financing the contractor's Government contracts, insofar as CB advanced funds to F in the refinancing to protect its own interests in prior loans to the contractor, CB is entitled to be subrogated to F's rights with regard to the subject contract. One who pays another's debt to protect his own rights and interests is not ordinarily considered a volunteer and may be subrogated to the creditor's rights.

Subrogation ⟸ 41(1)

Syllabus

Pleading and practice; parties; standing to sue or be sued.

[6] Under Court of Claims Rule 33(a) a plaintiff need not allege its capacity to sue; if defendant wishes to question capacity it must do so by specific negative averment. Where defendant's answer fails to raise the issue of plaintiff's capacity to sue in its own name, an attack via summary judgment motion is improper.

Courts ⇐ 463, 470

Contracts; assignment of claims; Government approval of assignee.

[7] Neither case law nor the legislative history of the Assignment of Claims Act supports a contention that a proper assignee must obtain Government approval in order to bring an action in its own name seeking recovery under a Government contract.

United States ⇐ 135

Contracts; assignment of claims; prohibition against assignment; exception from prohibition; real party in interest.

[8] Courts have developed exceptions to the Assignment of Claims Act, permitting the real party in interest to bring suit against the Government where the interest has devolved by operation of law. In determining if the real party in interest will be permitted to bring an action under the Act, an important consideration is whether such practice would encourage violation of the Act's policy primarily to prevent fraud and secondarily to avoid multiple litigation. Where the claims upon which plaintiff-bank is suing developed either from the beneficiary or subrogee role, as the court has so determined, plaintiff is the real party in interest, and may maintain the present action in its own name without defendant's consent.

United States ⇐ 111(4)

Pleading and practice; parties; standing to sue or be sued; real party in interest.

[9] To adopt the contention that under the Assignment of Claims Act Government consent is necessary before a proper assignee can sue in its own name would contravene the strong policy behind Court of Claims Rule 61(a) that actions be brought in the name of the real party in interest.

United States ⇐ 135

Contracts; assignment of claims; Government approval of assignee; Government conduct.

[10] Assuming *arguendo* that Government consent is required in order to permit the present plaintiff to sue in its own name, where the Government consistently treated plaintiff as the proper party during contract performance and subsequently during other problems relating to the contract, defendant's conduct demonstrates its consent to the assignment.

United States ⇐ 135

Contracts; subrogation; creditor's rights.

[11] A subrogee stands in the shoes of the subrogor and has no better rights than possessed by the latter.

Subrogation ⇐ 7(1)

Syllabus

Contracts; assignment of claims; discharge of Government; what constitutes.

[12] Where plaintiff-bank CB in an attempt to forestall F, the legal holder of the right to receive the subject contract proceeds, from calling its loans to contractor T in the amount of $52,812, allowed T to draw a check on CB for $45,000 payable to F, and F and CB entered into a refinancing arrangement whereby F transferred to CB its security interests in T's receivables, including Government contract rights, in exchange for releasing the $45,000 upon which CB held a prior lien based on independent loans to T, together with payment of $7,812, the payment in effect of $52,812 to F made by CB (in its beneficiary or subrogee role as determined by the court) did not discharge defendant's liability on the subject contract.

United States ⇐ 111(8)

Contracts; assignment of claims; assignee's right to contract proceeds in excess of contract performance loans; set-off.

[13] Where contractor T assigned to bank F the right to proceeds of the subject contract free of defendant's set-offs to secure performance loans, F also obtained a capacity to advance additional funds to T and receive funds from the subject contract beyond the payments specifically required, free of defendant's set-off claims arising independently of said contract. CB bank as assignee of F's rights under the contract, and in its role of beneficiary or subrogee, also obtained the right to advance more funds to T and to receive additional set-off protection encompassing extra amounts awarded under the contract.

United States ⇐ 111(2)

Contracts; Assignment of Claims Act; participation in financing by assignee.

[14] Since the legislative intent in amending the Assignment of Claims Act in 1940 and 1951 was to provide funds to a contractor for completion of Government contracts and to encourage revolving credit by avoiding tying particular loans to particular contracts, the overall benefit to the Government must be assessed in determining a lender's qualification for set-off protection. Where the goal of the Act to encourage completion of Government contracts would have been thwarted had additional loans not been made, the "participation in the financing" requirement is met not only to the extent of funds advanced at the time of a given assignment or reassignment, but also in the amount of funds previously furnished to assist completion of ongoing Government contracts. Form of the financing is not crucial.

United States ⇐ 111(2)

Statutes; construction and operation; judicial interpretation; furtherance of legislative intent.

[15] While each case is confined to its particular facts, this does not mean that the court is forced to put on blinders. A key factor in any decision is the potential ramification of the result. A court must be particularly cognizant of the implications of a given case

in the situation where it is confronted with clear evidence of legislative intent and must formulate an application of the statute which furthers such congressional purpose.

Statutes ⇐ 181(1)

Interest; claims against the United States; when allowable.

[16] Interest on a claim against the Government is not allowed absent a showing that a statute or contract expressly gives a right to collect interest. 28 U.S.C. § 2516.

United States ⇐ 110

Pleading and practice; summary judgment; when appropriate.

[17] Where the evidence before the court is not meaningfully correlated to an ultimate issue in the case, summary judgment cannot be granted on such issue and a remand to the trial judge for further proceedings is required.

Courts ⇐ 470

Joseph H. Levie, attorney of record for plaintiff. *Franklin N. Meyer*, of counsel.

Leslie H. Wiesenfelder, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, NICHOLS, and KUNZIG, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

Plaintiff, First National City Bank, comes before the court seeking a recovery as assignee of certain Government contract rights, ($54,369.37 plus interest) free of defendant's independent set-off claims. The contract in question contains set-off protection language. Under the facts of the instant action, plaintiff has standing to sue either as beneficiary of a prior assignment of the contract, or as subrogee, and may use the set-off protection provisions. We hold for plaintiff.

I.

Facts:

The facts are somewhat involved. The genesis of the present claim is found in a December 28, 1966, contract between Trilon Research Corp. (Trilon) and defendant. For a consideration of $87,318.46 Trilon agree to prepare and update certain Navy technical manuals. On April 19, 1967, defendant

made an initial progress payment under the contract to Trilon in the amount of $46,527.43.

The contract contained the usual financing and assignment clauses, incorporating by reference the provisions of the Armed Service Procurement Regulations (ASPRs), Paragraph 7-103.8 ASSIGNMENT OF CLAIMS (Feb. 1962), which in turn is based on the Assignment of Claims Act.[1]

Pursuant to these provisions, Trilon,[2] Franklin National Bank (Franklin), and the Small Business Administration (SBA) entered into a financing arrangement. Trilon obtained a loan of $250,000, $125,000 from Franklin and the balance from the SBA. As collateral, Franklin and the SBA took a lien on Trilon's inventory and receivables. The lenders, with Franklin acting as trustee, also obtained an assignment of Trilon's right to Government contract payments, including but not limited to, the contract at issue in the present case.[3] Defendant received notice of Trilon's assignments on May 12, 1967. The parties completed the initial financing in July 1967.

By November 1968, Trilon had completed its work on the technical manual contract. In addition to the $46,527.43 progress payment already made to Trilon, defendant had further paid Franklin (as trustee) the remaining $40,791.03. However, "accord and satisfaction" was delayed due to a dispute concerning amounts Trilon had earned for extra work.

One year later plaintiff entered the scene by making loans to financially troubled Trilon. The initial loan was for more than $250,000. In September 1969, the SBA advised Franklin that it had agreed to subordinate its one-half interest in Trilon's inventory and receivables (including Trilon's Government contracts) to plaintiff. Subsequently, plaintiff loaned Trilon additional amounts and is now owed more than $400,000 by Trilon.

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[1] 31 U.S.C. § 203 (1970) and 41 U.S.C. § 15 (1970). *See Part* III, *infra*.

[2] Through a subsidiary, P & D Electronics Co.

[3] The primary purpose of Trilon's formation and the bulk of its operations were directed to Government contract work. The technical manual contract, while central to the instant case, cannot be viewed as an isolated or even a crucial part of the various financing arrangements.

Note also, that the SBA agreed to subordinate its one-half interest in the collateral to Franklin.

Still later, in September 1971, Franklin found itself in severe economic difficulty. Franklin "called" its loans to Trilon and threatened to call the SBA's loan. Attempting to forestall this action, Trilon issued a $45,000 check payable to Franklin and drawn on plaintiff. However, plaintiff held a prior right to the $45,000 based upon the independent loans to Trilon. To permit Trilon to continue work on its ongoing Government contracts, Franklin and plaintiff entered into a refinancing arrangement. Franklin transferred its security interests in Trilon's receivables (including Government contract rights) to plaintiff. Plaintiff paid Franklin $52,812.[4]

As a result of the refinancing, in November 1971, Trilon executed a second "notice of assignment" of the technical manual contract. Trilon assigned the payment rights to plaintiff. The notice was sent to defendant who neither rejected nor accepted it but remitted the documents to plaintiff to obtain a release of Trilon's prior assignmment to Franklin.

From late 1968 through 1971, the dispute over Trilon's entitlement to additional compensation on the technical manual contract continued. Progress toward resolution finally began in February 1972, when the Contracting Officer (CO) ruled that Trilon had earned an additional $62,181.37. Trilon filed a notice of appeal, but the parties subsequently reached an agreement to adopt the CO's figure. Significantly, a copy of defendant's agreement to resolve the dispute was sent by the Government not to Franklin or the SBA but to plaintiff.

However, plaintiff and defendant failed to agree on plaintiff's right to receive the $62,181.37. Defendant claimed that it had sufficient set-offs [5] to obliterate plaintiff's entitlement to the award. Plaintiff countered that the technical manual contract contained set-off protections enabling it, as assignee, to receive the $62,181.37, free of defendant's set-off claims.

On December 3, 1973, defendant submitted this question to the General Accounting Office (GAO). The Comptroller General held that plaintiff could recover $7,812 free of de-

[4] The $52,812 represented Franklin's remaining risk on the $125,000 loan. To make the payment plaintiff released its priority rights to the $45,000 check and paid Franklin an additional $7,812 in cash.

[5] At this time, Trilon owed the IRS $157,312.73 and was also indebted to the Government for unliquidated progress payments on an unrelated Government contract in the amount of $213,211.49.

fendant's set-off claims.[6] However, the GAO disallowed the balance of the $62,181.37 on the basis that plaintiff was precluded from use of the set-off protections because it had not participated in the financing of the technical manual contract. Since plaintiff had not extended funds toward the contract, reasoned the GAO, plaintiff could not assert the set-off protections contained in the Assignment of Claims Act and the ASPRs. Comp. Gen. Dec. B–180271 (Aug. 22, 1974).

Plaintiff then brought the instant action in its own name[7] to recover the $54,369.37 ($62,181.37 less $7,812) plus interest, disallowed by the GAO.[8]

II

Positions of the Parties:

Plaintiff argues it has standing to sue on the technical manual contract. First, contends plaintiff, it may sue as the "real party in interest" in this matter. Second, plaintiff asserts a right to bring the present action as beneficiary of the 1967 assignment from Trilon to Franklin. Third, plaintiff urges standing as subrogee of Franklin's interests. Finally, plaintiff suggests that it has acquired a right to maintain an action as the legal assignee of the present claim under the Assignment of Claims Act.

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[6] The GAO decision casts plaintiff's recovery in terms of "assignee-principal" or "beneficiary-principal." However, its reasoning appears to be based on a subrogation theory. According to the GAO, Franklin by virtue of the 1967 assignment was entitled to receive $125,000 from the Government or Trilon, without set-off. Franklin had received all but $7,812 of the $125,000 at the time of the refinancing. When plaintiff paid Franklin the $7,812 it stepped into Franklin's shoes and obtained the right to receive $7,812 in Government contract proceeds free of set-offs. The fact that Franklin had been paid the $7,812 did not void defendant's liability for this amount because defendant was a stranger to the refinancing and so far as the Government was concerned, still owed Franklin the $7,812.

Note that the GAO opinion fails to deal with the release of the $45,000 check by plaintiff to Franklin. Presumably the GAO felt that this constituted a payment by Trilon to Franklin, rather than a payment by plaintiff. However, the GAO's failure to explain the reasons for its award of $7,812 to plaintiff rather than $52,812 ($7,812 plus $45,000) casts some doubt on the validity of the GAO's conclusion.

[7] Neither the European–American Bank & Trust Co. (as purchaser of certain Franklin assets) nor the Federal Deposit Insurance Corp. (as transferee of other Franklin assets) appeared in this action, despite the issuance of Ct. Cl. Rule 41(a)(1) notices to appear as parties. In fact, the FDIC's response indicates that neither it nor Franklin has any such interest.

[8] Plaintiff's petition seeks $55,188 plus interest. However, this appears to be based upon an erroneous figure attributed to the CO's award and plaintiff's summary judgment brief revises the claim to $54,369.37.

According to plaintiff, once the standing issue is resolved in its favor, it may sue on the contract and obtain the benefit of the set-off protective language contained therein. Thus, plaintiff argues, it is entitled to recover the amounts at issue here, free of defendant's set-off claims.

In opposition defendant contends that it may set-off Trilon's independent debts against any funds due plaintiff on the technical manual contract. If plaintiff cannot sue on the contract, it cannot use the benefit of the set-off protections. Second, says defendant, even if plaintiff has standing to sue it can assert no greater rights than Franklin. Since Trilon and the Government were discharged from any liability on the technical manual contract by plaintiff's voluntary payments to Franklin, plaintiff can recover nothing. Third, defendant argues that plaintiff has not participated in the financing of the technical manual contract and loses the benefits of the set-off protections by its failure to come within the requirements of the ASPRs and the Assignment of Claims Act.

The issues in the present action center on the question of plaintiff's entitlement to the set-off protections contained in the Assignment of Claims Act, the ASPRs and the technical manual contract. The case thus resolves into an inquiry of whether plaintiff's financing activities comport with those envisioned by Congress in its establishment of the set-off protections for assignee-lenders. Based on the facts of this case, after considering the law, the motions and briefs of the parties, and after oral argument, we hold that plaintiff is entitled to recover the $54,369.37, free of set-off liability.

III

The Set-off Protections:

From the time of the earliest contract awards in the nineteenth Century, assignment of Government contract claims has consistently been restricted by statute. *See e.g.*, *Continental Bank & Trust Co.* v. *United States*, 189 Ct. Cl. 99, 103, 416 F. 2d 1296, 1298 (1969). The purpose of such restrictions is to protect the Government by preventing fraud, avoiding multiple litigation and preserving set-off and

counterclaim defenses against contractor-assignors. *Consumers Ice Co.* v. *United States*, 201 Ct. Cl. 116, 119, 475 F. 2d 1161, 1163 (1973). However, by 1940 it became apparent that the restrictions were hindering the financing of Government contract work and thereby unduly constricting competitive bidding.

In 1940, Congress amended the Act to permit contract assignment to "a bank, trust company, or other financing institution" participating in the financing of Government contracts which provided for payments aggregating $1000 or more. Act of Oct. 9, 1940, 54 Stat. 1029 (1940). The Act's amendments also provided that assignees would be free from Government set-offs. As stated by the court in *Chelsea Factors, Inc.* v. *United States*, 149 Ct. Cl. 202, 181 F. Supp. 685 (1960):

> The 1940 Amendment to the Assignment of Claims Act was intended to facilitate the financing of Government contracts by private capital in the way in which private capital normally operates in financing the country's economy. [*Id.*, 149 Ct. Cl. at 210, 181 F. Supp. at 690].

After the 1940 amendment, the Comptroller General construed the Act's set-off protections quite narrowly. Thus, in 1951 Congress enacted another amendment to broaden the set-off protection. Act of May 15, 1951, 65 Stat. 41. *See Continental Bank*, *supra*, 189 Ct. Cl. at 106, 416 F. 2d at 1300–01.

Such legislative action clearly demonstrates the intent of Congress to have the Act's amendments broadly, not narrowly, construed in order to encourage the financing of Government contracts. As stated by Supreme Court Justice Reed (Ret.), sitting by designation in *Coleman* v. *United States*, 158 Ct. Cl. 490 (1962):

> The progressive liberalization of the Act by its various amendments manifests the purpose of Congress to protect effectively assignments in accordance with the Act. [*Id.* 158 Ct. Cl. at 492–93].

With background established, we turn to the specific set-off protections at issue in the instant case.

Trilon's technical manual contract included by reference the standard financing and assignment provisions provided in the ASPRs. Drafted with reference to the Assignment of

Claims Act, the ASPRs permit assignment and reassignment in certain instances. They also grant set-off protection to assignees:

> [I]f this contract provides for payments aggregating $1,000 or more, claims for monies due or to become due the contractor from the Government under this contract may be assigned to a bank, trust company, or other financing institution, * * * and may thereafter be further assigned and reassigned to such institution. Any such assignment or reassignment shall cover all amounts payable under this contract and not already paid, and shall not be made to more than one party, except that any such assignment or reassignment may be made to one party as agent or trustee for two or more parties participating in such financing. Unless otherwise provided in this contract, *payments to an assignee of any monies due or to become due under this contract shall not, to the extent provided in said [Assignment of Claims] Act, as amended, be subject to reduction or set-off.* [ASPR ¶ 7-103.8 (1962) (emphasis added)].

Plaintiff contends it may use the benefits of this set-off protection language because it is entitled to sue on the contract.

The ASPR relied upon by plaintiff is based on the Assignment of Claims Act, 31 U.S.C. § 203 (1970) and 41 U.S.C. § 15 (1970). As a general rule, the Act prohibits assignments of claims against the Government. However, as stated above, Congress has provided for certain assignments in order to encourage financing of Government contracts and has granted set-off protection rights to eligible assignees:

> The provisions of the preceding paragraph [invalidating assignments of claims against the Government] shall not apply in any case in which the moneys due or to become due from the United States * * * under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution * * *: *Provided*,
>
> * * * * *
>
> 3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts payable under such contract and not already paid, shall not be made to more than one party, and shall not be

> subject to further assignment, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing;
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> * * * * *
>
> * * * [P]ayments to be made * * * to the assignee of any moneys due or to become due * * * shall not be subject to reduction or set-off for any liability of any nature of the assignor to the United States * * * which arises independently of such contract * * *. [31 U.S.C. § 203 (1970) and 41 U.S.C. § 15 (1970)].

It is these code provisions containing the set-off protection language, as incorporated into the technical manual contract through the ASPR cited above, that plaintiff relies upon in the instant case.

We now turn to the problem of whether plaintiff has standing to bring the instant action.

IV

Standing:

Plaintiff argues that it has standing to sue on the contract (and to obtain the benefit of the setoff protections) as (1) real party in interest, (2) beneficiary of the 1967 assignment, (3) subrogee of Franklin's interests, or (4) legal assignee based on Trilon's 1971 reassignment. The GAO held that plaintiff could recover $7,812, apparently as subrogee of Franklin, but held that plaintiff could not recover any additional portions of the $62,181.37. Comp. Gen. Dec. B–180271, *supra*. Plaintiff now seeks to recover, free of set-offs, the $54,369.37 disallowed by the Comptroller General. Defendant counters that plaintiff has no standing to sue on the contract and that the set-offs obliterate the $54,369.37.

We hold that plaintiff has standing to sue on the contract either as beneficiary of the 1967 assignment from Trilon to Franklin, or as subrogee of Franklin's rights under the 1971 refinancing.[9] Further, we conclude that plaintiff may bring the instant action in its own name.

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[9] We determine that plaintiff may sue as beneficiary or subrogee. Therefore, we do not address plaintiff's other standing arguments.

A. Plaintiff as Beneficiary

Plaintiff has standing to maintain the present action as beneficiary of Trilon's 1967 assignment of the technical manual contract to Franklin (initially as trustee for itself and the SBA). The primary basis for this conclusion is the court's opinion in *Chelsea Factors, Inc.* v. *United States*, 149 Ct. Cl. 202, 181 F. Supp. 685 (1960). There, we had occasion to construe the Assignment of Claims Act and contract provisions identical to those presented in the case at bar. In *Chelsea*, a food wholesaler had contracted with the Government to supply frozen vegetables. The contractor assigned its payment rights to a bank. The bank and a factoring company in return agreed to release frozen vegetables (upon which they held a warehouseman's lien) so that the food could be delivered to the Government. The contractor made two deliveries to the Army, but shortages were discovered. Defendant withheld payment. When the factoring company brought suit in the Court of Claims for payment on the food actually delivered, the Government attempted to set-off certain fraud liability of the wholesaler owed to defendant.

The court held that the factoring company, although not named as a party to the assignment of the contract, was entitled to use the set-off protections found in the Act and the contract as beneficiary of the assignment from the contractor to the bank.

> The arrangement between the bank, the plaintiff, and Suburban [the contractor] in the instant case, made the bank a trustee for the plaintiff of Suburban's assignment to the bank. [*Chelsea*, *supra*, 149 Ct. Cl. at 208, 181 F. Supp. at 689].

The instant case is analagous to *Chelsea*. Franklin, after reassigning the equitable right to receive the technical manual contract proceeds, continued to hold the legal right to the proceeds as trustee.[10] The beneficial interest in the contract passed to plaintiff. The provisions of the Act and the ASPRs were not violated because Franklin, a single party, continued to act as trustee for plaintiff and the SBA. As noted by the

[10] In fact, on the advice of the SBA, Franklin specifically declined to release its legal assignment and continued to act as trustee or disbursing agent.

court in *Chelsea*, the ASPRs specifically permitted assignment and *reassignment:*

> [C]laims for monies due or to become due the contractor from the Government under this contract may be assigned to a bank, trust company, or other financing institution * * * and *may be thereafter further assigned and reassigned* to such institution. [ASPR, ¶ 7–103.8, *supra*, (emphasis added)].

Plaintiff may sue as beneficiary because it meets the conditions to valid assignment imposed by the ASPRs and the Act. The main conditions contained in the Act are that: (1) the contract payments aggregate $1000 or more; (2) the assignee must be a bank, trust company or other financing institution; (3) only one party is the legal assignee; and (4) the assignee has participated in the financing of Government contracts.[11] Such conditions *are met* in the instant case. The technical manual contract provided for payments in excess of $1000, all assignees (both legal and beneficial) are banks or financing institutions, and only one party (Franklin) acted as trustee for other assignees. We shall later see that plaintiff also meets the prerequisite of having participated in the financing.[12]

In short, plaintiff has standing to sue as beneficiary of the 1967 assignment of the contract by virtue of Franklin's 1971 reassignment to plaintiff of its beneficial interests in the technical manual contract proceeds.

B. Plaintiff as Subrogee

Plaintiff also has standing to assert any rights held by Franklin with respect to the contract, as *subrogee.*

As a general rule, subrogation applies where a party "not acting voluntarily, but under some compulsion" pays a debt or discharges an obligation for which another is primarily liable and which "in equity and good conscience ought to be discharged by the latter." *See, e.g., Compania Anonima Venezolana de Navegacion* v. *A. J. Perez Export Co.*, 303 F. 2d 692, 697 (5th Cir. 1962). In such circumstances, the

[11] To prevent multiple claims on the same contract and avoid multiplicity of actions. *See, e.g., Consumers Ice Co., supra.*

[12] *See* Part VI, *supra.*

subrogee "stands in the place" of the original creditor and obtains equivalent but no greater rights against the debtor than held by the original creditor. *United States* v. *Munsey Trust Co.*, 332 U.S. 234, 242 (1947).

Before the 1940 amendments to the Assignment of Claims Act, courts would not apply the doctrine of subrogation against the Government in contract actions. *Munsey Trust*, *supra*. The basis for such action rested on the fact that assignments of claims against the United States were forbidden. To apply subrogation would have defeated the purpose of the anti-assignment Act. However, with passage of the amendments to the Act in 1940, so long as conditions to assignment (discussed *supra*) are met, there should be no bar to application of the doctrine of subrogation against defendant.

As previously discussed, the conditions on assignment have been fulfilled in the instant case.[13] The contract called for payments in excess of $1000; plaintiff is a bank; Franklin acted as sole legal assignee, and plaintiff participated in the financing of Trilon's Government contracts. Thus, insofar as plaintiff advanced funds to Franklin in the 1971 refinancing, plaintiff is entitled to be subrogated to Franklin's rights with regard to the technical manual contract. The GAO so held (although limited the extent of the subrogation to the $7,812 cash payment) when it concluded:

> First National City may, in essence, have obtained for its $7812 the same but no greater rights than Franklin itself possessed under the Trilon assignment—essentially the right to payment of nearly $8,000, without any setoff. [Comp. Gen. Dec., B–180271, *supra* at 6].

But defendant says that plaintiff is not subrogated to Franklin's rights because it is a mere volunteer. We agree that a volunteer may not obtain any subrogation rights. Payment of the debt must result from some compulsion. *Prairie State Bank* v. *United States*, 164 U.S. 227, 231 (1896); *Aetna Life Ins. Co.* v. *Middleport*, 124 U.S. 534, 549 (1888); *Anderson* v. *United States*, 97 Ct. Cl. 545, 550 (1942). However, defendant forgets that subrogation will be applied in favor of parties who act to protect their own interests. One

[13] *See* notes 10–12, *supra*, and accompanying text.

who pays another's debt to protect his own rights and interests is not ordinarily considered a volunteer and may be subrogated to the creditor's rights. *Federal Deposit Insurance Corp.* v. *American Surety Co.*, 39 F. Supp. 551 (W.D. Ky. 1941). *See also Nippolt* v. *Farmers' & Merchants' State Bank*, 186 Minn. 342, 243 N.W. 136 (1932) (Bank agreed to pay mortgage to protect other security interests held entitled to assignment of note and mortgage).

Clearly, plaintiff did not pay Trilon's debt as a volunteer but did so to protect its own interests in the prior loans made to Trilon. Both Franklin and Trilon faced severe economic difficulties in 1971. Franklin had called its loans to Trilon and had threatened to call the SBA's. If Franklin had persisted, Trilon might have been forced into receivership or bankruptcy, endangering plaintiff's loans to Trilon. Plaintiff was no volunteer.

Thus we agree with the GAO that plaintiff as subrogee acquired standing to assert Franklin's rights against defendant, although we shall discuss in Part V, *infra*, why we disagree with the GAO's interpretation of the scope of such rights.[14]

C. Proper Party Plaintiff

Having determined that plaintiff has standing to bring the instant action either as beneficiary or as subrogee, we turn to defendant's contention that plaintiff has no capacity to bring the present suit in its own name. Although agreeing that plaintiff is the real party in interest in this matter, defendant claims that Government consent is needed for substitution of the real party in interest as plaintiff in suits under the Assignment of Claims Act. It cites *Consumers Ice Co.*, *supra*, and *Beaconwear Clothing Co.* v. *United States*, 174 Ct. Cl. 40, 355 F. 2d 583 (1966), for this proposition. Because, defendant says, such consent has never been given, plaintiff lacks capacity to bring this action. For several reasons we cannot accept defendant's views and hold that plain-

[14] We reject the Government's contention that allowing plaintiff standing to sue as subrogee would permit an equitable right (subrogation) to override the statutory requirements of the Act. Our holding that subrogation may be applied against defendant only extends to the situation where strict conditions contained in the Act are otherwise met.

tiff is entitled to bring the instant action in its own name.[15]

First, neither *Consumers* nor *Beaconwear* mandates the requirement that an assignee under the Assignment of Claims Act obtain Government approval in order to bring an action in its own name.

In *Beaconwear*, a subcontractor-reassignee attempted to gain the benefit of the set-off protections of the Act despite the fact that he was not a financing institution and had not participated in the financing of any of the assignor's Government contracts. The court held that the defendant had not waived its objections to plaintiff's use of the set-off protections because the Contracting Officer had not received *notice* of the reassignment to the subcontractor. Moreover, it was further held that the subcontractor could not sue in its own name as a prime contractor because it had no privity with the Government, and had not been dealt with directly by defendant. The consent requirement in *Beaconwear*, if any, relates to the contractor-Government relationship, not to the Assignment of Claims Act.

Although defendant's consent requirement would seem at first glance to be bolstered by *Consumers*, a close analysis proves such a view to be erroneous. In that case, the plaintiff's counsel, *not the court or the Government*, agreed that in a suit under the Act, the real party in interest could only be substituted as plaintiff with the consent of defendant.

> Plaintiff concedes that Texas International Company [the real party in interest] cannot be substituted as plaintiff without consent of the United States because of the Assignment of Claims Act, 31 U.S.C. § 203 (1970). On the latter point, defendant has been silent. [*Consumers*, *supra*, 201 Ct. Cl. at 119, 475 F. 2d at 1163].

In fact, the court appears to disagree with this legal stipulation by Consumers' attorney, although it refused to rule on the question:

> There are various exceptions to this Act [including rights created] by operation of law * * * [T]his ap-

[15] We address defendant's capacity argument despite the fact that it has not been properly raised. Ct. Cl. Rule 33(a) provides that a plaintiff need not allege its capacity to sue. However, if defendant wishes to question the plaintiff's capacity, it must do so "by specific negative averment." Defendant's answer in the present action fails to raise an issue as to plaintiff's capacity to sue in its own name. Therefore, defendant's attack on plaintiff's capacity in the summary judgment motion is improper.

> pears to be the situation here. The purposes of the Act, often stated, to prevent fraud, to avoid multiple litigation, and to protect the defenses the United States may have against the assignor by way of setoff and counterclaim, would not appear to be violated by substitution of Texas International Company as plaintiff and the real party in interest. *However, it is not necessary to decide this issue now* * * * [*Id.*, 201 Ct. Cl. at 119–20, 475 F. 2d at 1163 (emphasis added)].

Neither *Beaconwear* nor *Consumers* stands for the proposition that defendant must consent to the assignee or reassignee's suit under the Assignment of Claims Act before the assignee or reassignee may bring the action in its own name as proper party plaintiff. In fact, there is precedent to the contrary. In *Chelsea Factors*, *supra*, a reassignee brought suit in its own name to recover on the contract. It did not appear that defendant consented to Chelsea's maintenance of the action.[16] The court held that plaintiff could sue in its own name under a belated legal reassignment without discussing any consent requirement. *Id.*, 149 Ct. Cl. at 214, 181 F. Supp. at 692.

Beyond the fact that the case law does not support defendant's consent requirement, a second reason exists for denying the Government's capacity argument. As noted in *Consumers*, *supra*, courts have developed exceptions to the Assignment of Claims Act, permitting the real party in interest to bring suit against the Government where the interest has devolved by operation of law. *Webster Factors, Inc.* v. *United States*, 193 Ct. Cl. 892, 900–01, 436 F. 2d 425, 429 (1971); *Patterson* v. *United States*, 173 Ct. Cl. 819, 823, 354 F. 2d 327, 329 (1965). Such transfers include suits by *subrogees*, *United States* v. *Aetna Casualty & Surety Co.*, 338 U.S. 366 (1949), and bankruptcy trustees, *McKay* v. *United States*, 27 Ct. Cl. 422 (1892).

Of manifest importance in determining if the real party in interest will be permitted to bring an action under the Act is whether such practice would encourage a violation of the Act's policy "primarily to prevent fraud and secondarily to avoid multiple litigation." *Webster*, *supra*, 193 Ct. Cl. at 900,

[16] In fact, rather than give its consent the Government argued that plaintiff could not sue because it had never given notice of the reassignment. The court rejected this argument and held that notice of a prior assignment to another party was sufficient.

436 F. 2d at 429; *Patterson*, *supra*, 173 Ct. Cl. at 823, 354 F. 2d at 329. It is clear that such policy will not be violated by permitting plaintiff to maintain the present suit. The claims upon which plaintiff sues developed either from the beneficiary or subrogee role. The cases cited above permit this action, without defendant's consent, in the name of plaintiff. Defendant makes no allegations of fraud. Other participants to the financing (Franklin, Trilon, and the SBA) have eschewed any interest in the proceeds at issue here.[17]

Thus based upon these policy considerations, under the facts of this case plaintiff may sue in its own name without defendant's consent.

Third, adoption of defendant's consent requirement would, in effect, create an exception to Ct. Cl. Rule 61(a) based on the Assignment of Claims Act. Rule 61(a) specifies the general rule that actions in this court be brought by the real party in interest.

> *Every action shall be prosecuted in the name of the real party in interest;* but an executor, administrator, guardian, trustee of an express trust * * * or other representative appointed by a judicial tribunal, or a party authorized by statute, *may sue* in his own name without joining with him the party for whose benefit the action is brought. [Ct. Cl. Rule 61(a) (emphasis added)].

Defendant does not dispute the fact that plaintiff is the real party in interest. Instead it contends that under the Act, Government consent is necessary before an assignee can sue in its own name. The Act contains no such express requirement and, as discussed above, defendant cites no legislative history or case law to this effect. In stark contrast is the strong policy behind Rule 61(a) that actions be brought in

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[17] Franklin's successors have declined to appear in this action. *See* note 7, *supra*. Trilon has assigned its interest to plaintiff, and the SBA has subrogated any of its claims.

Note also that another purpose of the Act, to preserve the Government's set-offs and counterclaims against the contractor, while not considered of major importance in *Webster* and *Patterson*, is not violated by allowing plaintiff to bring the instant action in its own name. Plaintiff's rights here are obtained derivatively from Franklin. Defendant has already relinquished its set-off and counterclaim defenses against Trilon by assenting to the Franklin assignment. There is no further erosion of defendant's rights in allowing plaintiff to step into the shoes of Franklin. Indeed, if the philosophy of the amendments, to encourage the financing of Government contracts, is to be furthered, proper reassignments must permit the reassignees to bring actions against defendant.

the name of the real party in interest. Defendant simply produces no basis for implying a consent requirement as an exception to this rule in Assignment of Claims Act cases.

Finally, even if defendant's consent were required in order to permit plaintiff to bring the present action in its own name, we would still find that this action is proper. Although defendant has never expressly consented, the Government's course of conduct demonstrates that consent has impliedly been given. Defendant has consistently treated plaintiff as the proper party in this action. While Trilon and Franklin were experiencing financial difficulties, defendant was quite happy to have plaintiff bolster them so that work could continue on Government contracts. Although defendant never specifically consented to the reassignment to plaintiff, neither did it disapprove. Later, when the technical manual contract dispute was resolved, defendant sent a copy of its agreement *not to Franklin or the SBA but to plaintiff*. When concurrence could not be reached on plaintiff's entitlement to the proceeds, defendant submitted the problem to the GAO. Plaintiff, not Franklin or the SBA, appeared before the GAO.

Defendant's conduct amply demonstrates that it has consented.

We hold that plaintiff has standing to bring the instant action, either as beneficiary of the 1967 assignment from Trilon to Franklin or as subrogee of Franklin pursuant to the 1971 refinancing. We further conclude that plaintiff has capacity to bring the instant suit in its own name. Now, the extent of plaintiff's derivative rights, as beneficiary or subrogee, must be determined.

V

Scope of Plaintiff's Rights

Even if plaintiff has standing to sue in its own name, defendant argues, it cannot recover because it has no greater rights than Franklin. Defendant reasons that Trilon's debt to Franklin has been discharged in full and plaintiff can recover nothing. Defendant's derivative rights approach is correct, but it errs in the proposed application to the facts

of this case. We hold that plaintiff is entitled to recover the entire $54,369.37 as beneficiary or as subrogee.

Defendant's initial observation is accurate. Plaintiff can obtain no greater rights than those possessed by Franklin. This is true where plaintiff sues as subrogee. "A subrogee stands in the shoes of the subrogor and has no better rights than possessed by the latter." *Berkeley* v. *United States*, 149 Ct. Cl. 549, 555, 276 F. 2d 9, 12 (1960). *See also*, *United States* v. *Munsey Trust Co.*, 332 U.S. 234 (1947); *Phoenix Insurance Co.* v. *Erie & Western Transportation Co.*, 117 U.S. 312, 321 (1886). It is equally valid where plaintiff sues as beneficiary:

> Since the Bank's [the reassignor's] debt has been discharged in full, it no longer has a valid claim against the United States either for itself or as a trustee for Spiotta [the reassignee] who, in any event, would have no greater rights than the Bank possesses under the first assignment. [*Beaconwear Clothing Co.*, *supra*, 174 Ct. Cl. at 52, 355 F. 2d at 590].

Using this logic, defendant argues that Franklin has been discharged in full by plaintiff's 1971 refinancing. Defendant says Franklin could not recover from the Government and neither can plaintiff.

Defendant misconstrues the meaning of "discharge" and the nature of the subrogation or beneficiary role. At the time of the 1971 refinancing Trilon still owed Franklin $52,812. Plaintiff paid Franklin this amount by releasing a $45,000 check upon which it held a prior lien and by giving Franklin $7,812 in cash. Defendant says this transaction "discharged Franklin." We decline to follow such an interpretation.

Were we to adopt the concept of discharge urged by defendant we would obliterate the doctrine of subrogation. As previously discussed, subrogation is applied where a party "not acting voluntarily, but under some compulsion" pays a debt or discharges an obligation for which another is primarily liable and which "in equity and good conscience ought to be discharged by the latter." *Compania Anonima*, *supra*. Yet by defendant's definition, anytime a third party paid a creditor on behalf of the debtor, the creditor would be discharged and the subrogee would have no rights against the debtor. In other words, defendant's "catch-22" argument

would have us read the law of subrogation out of the books. Clearly, such an approach is erroneous, and we decline to follow it.

The GAO decision itself rejected defendant's "discharge" approach, at least with regard to the $7,812 cash payment made by plaintiff to Franklin. The GAO properly pointed out that defendant was a stranger to the 1971 refinancing. Thus, the Government's liability on the technical manual contract was not discharged by any payments made by plaintiff to Franklin. Comp. Gen. Dec. B–180271, *supra* at 6. Although as we shall discuss *infra*, the GAO, like defendant, partially misinterpreted the scope of the rights transferred to plaintiff; it correctly declined to hold that plaintiff's payment to Franklin discharged the debt as far as defendant was concerned.

Alternatively, defendant argues that even if there was no 1971 discharge, the Government is not liable to plaintiff for any additional sums (other than the $7,812 awarded by the GAO) because the total extent of plaintiff's derivative rights was correctly determined by the GAO. For two key reasons this contention cannot be upheld. The GAO erroneously limited plaintiff's recovery.

First, plaintiff is at least entitled to an additional recovery based on the $45,000 check which plaintiff released during the 1971 refinancing. The GAO failed to deal with the issue of the check. Defendant says plaintiff's release of the check constituted a payment by Trilon to Franklin and Franklin was discharged to the extent of $45,000. To support this contention defendant cites the proposition that payment by a third party of a debt using funds of the debtor is equivalent to payment by the debtor, not the third party:

> Payment in a legal sense relates to a debt or an obligation of the party who pays. Payment may be made by the debtor or by another in his behalf. If it is paid by another, but with the debtor's money, it is payment by the debtor. [*Krichbaum* v. *United States*, 138 F. Supp. 515, 518 (E.D. Tenn. 1956)].

The check at issue here was drawn by Trilon, payable to Franklin, with plaintiff as payor bank. According to defendant, plaintiff's release of the check (by paying Franklin

the $45,000) was payment by a third party (plaintiff) of a debt (to Franklin) using the debtor's (Trilon's) funds.

Defendant ignores one crucial fact. Plaintiff held a prior claim to the $45,000 based upon its right of set-off:

> * * * [T]he right of a bank to a lien against money deposited with it and the right to set off a deposit against the depositor's indebtedness to the bank are part of the law merchant * * *. [*Kaufman* v. *First National Bank*, 493 F. 2d 1070, 1071 (5th Cir. 1974) (citation omitted)].

In short, plaintiff held the check subject to its right to set-off the loans previously made to Trilon. Trilon could not demand that plaintiff pay this sum over to Franklin. When plaintiff paid the $45,000 it did so, in effect, not with Trilon's money *but with its own*. Plaintiff's release of the check constituted a transfer of a property right worth $45,000 to Franklin in partial consideration for the reassignment of technical manual contract rights. Plaintiff received Franklin's claims against defendant not limited to the $7,812 but at least for $52,812. Plaintiff is entitled to recover at least an additional $45,000 in the instant action.

Second, beyond the question of the $45,000 check, plaintiff may recover the entire $54,369.37 based upon a right which both defendant and the GAO have apparently ignored. This is the right to advance funds under a revolving credit agreement, thereby extending defendant's duty to pay without regard to set-offs.

In the 1967 assignment Franklin received the right to collect amounts due under the technical manual contract free of defendant's set-offs. More important, Franklin also obtained a capacity to make additional loans to Trilon and extend the set-off protections contained in the technical manual contract. As stated by the court in *Continental Bank & Trust Co.* v. *United States*, 189 Ct. Cl. 99, 416 F. 2d 1296 (1969):

> * * * [D]efendant resorts to the contention that the set-off is permissible in this instance [where the specific funds due on the contract had been repaid], since under the common law of assignments, plaintiff's interest in the assigned collateral ceased when the loan made for the performance of the contract was repaid. * * *. This argument ignores the modern trend away from tying

> particular loans to particular security. Furthermore, the adoption of such a rule for the statutory assignment involved here would impair the familiar revolving credit financing device to which Congress referred when deleting the previously discussed set-off and reduction limitation provision from the 1951 amendments to the Act * * * [*Continental Bank*, *supra*, 189 Ct. Cl. at 108–9, 416 F. 2d at 1302].

Franklin obtained the right, in the 1967 assignment to make additional loans to Trilon and receive, free of defendant's independent set-off claims, funds from the technical manual contract beyond the payments specifically required.[18]

When plaintiff paid Franklin the $52,812 and received Franklin's rights it also obtained the right to advance more funds to Trilon and receive additional set-off protection encompassing extra amounts awarded under the technical manual contract. It is the nature of this right which compels the conclusion that plaintiff is entitled to recover the $54,369.47 free of defendant's set-offs.

As stated above, Congress, as part of its motives in enacting the Act's amendments, desired to encourage the revolving credit device.

> The 1940 Amendment to the Assignment of Claims Act was intended to facilitate the financing of Government contracts by private capital in the way in which private capital normally operates in financing the country's economy. [*Chelsea Factors*, *supra*, 149 Ct. Cl. at 210, 181 F. Supp. at 690].

Therefore, since plaintiff as subrogee or beneficiary obtained Franklin's right from the initial 1967 assignment, and since such rights related back, the scope of plaintiff's derivative rights against defendant is not limited to a set-off free recovery of the $7,812 cash payment. Nor is plaintiff limited to the $52,812 payment (cash plus the $45,000 check release). Plaintiff's right to recover free of defendant's set-offs extends to all loans to Trilon made in furtherance of Government contracts: somewhere in excess of $250,000. Therefore, plaintiff is entitled to recover the $54,369.37 at issue here.

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[18] Plaintiff and defendant disagree as to whether Franklin actually exercised such a right. Plaintiff alleges in its complaint that Franklin extended additional loans to Trilon in 1969. Defendant denies this allegation.

VI

Participation in the Financing:

Relying on the condition contained in the Act, that the assignee have "participated in the financing of Government contracts," defendant argues that plaintiff cannot obtain the benefits of the no set-off protections because it did not participate in the financing of the technical manual contract. This time, not only is defendant's application unsound, so is its theory.

In order to qualify under the Act for set-off protection, all conditions placed on assignments must be met. Under one such requirement, the assignee must have participated in the financing of Government contracts:

> [A]ny such assignment may be made to one party as agent or trustee for two or more parties *participating in such financing*. [31 U.S.C. § 203, *supra*; 41 U.S.C. § 15, *supra* (emphasis added)].

The theory underlying this condition was well stated in *Coleman, supra.*

> The Act was designed to make funds available to a contractor with which he could *complete his government contract*. If the loan is used for another purpose, the objectives of the Act are not satisfied. [*Coleman, supra*, 158 Ct. Cl. at 496 (emphasis added)].

Defendant says plaintiff could not possibly have participated in the financing of the technical manual contract because performance on the contract had been completed by the time plaintiff entered the scene.

In order to evaluate defendant's contention, we must formulate the proper test for determining the extent of plaintiff's financial participation in Trilon's Government contract ventures. Defendant would have the court adopt the "single loan method." Under such a test, the court would determine whether particular loan proceeds are used to complete a specific Government contract, the proceeds of which have been assigned to the lender. However, defendant ignores crucial features of the Act and the ASPRs.

As discussed above, one legislative purpose in amending the Act was to encourage the revolving credit device. In

order to promote this philosophy, Congress rejected proposals which would have tied particular loans to particular contracts. *See Continental Bank, supra.* Yet this is precisely the test defendant would have us adopt to determine whether a lender has "participated in the financing." Obviously, we cannot give credence to defendant's suggestion.

By a proper test the objectives of the Act, to provide funds for completion of Government contracts *and* to encourage revolving credit by avoiding tying particular loans to particular contracts, can both be achieved. Such a test measures whether plaintiff advanced funds in return for payment rights *on a number of Government contracts, some of which are in process.* In other words, the overall benefit to the Government must be assessed, rather than a particular benefit arising from completion of a particular contract.

Moreover, the *form* of the financing arrangement is not crucial. There are two possible situations where the Government benefits from the actions of a lender. In the first instance, the lender advances funds *directly* to a contractor to permit completion of Government contracts. Clearly, the lender has participated in the financing. The second instance is more subtle. Here the lender advances funds to a creditor of the contractor to prevent a reduction of the contractor's working capital employed in the completion of Government contracts. This second arrangement is more complex, but the net benefit to the Government is the same. In the first situation, the contractor has received funds to assist him in completing his Government contracts. In the second instance, the lender's action in forestalling creditors who would drain the contractor of funds, equally operates in aiding the contractor in the completion of Government contract work.

Applying this theory to the instant case, plaintiff meets the "participation in the financing" requirement. Initially, plaintiff participated in the financing of *other ongoing* Trilon Government contracts despite the fact that the technical manual contract had been completed before plaintiff's entry on the scene. Therefore, under the test we have formulated, plaintiff meets the "participation in the financing" requirement, although it did not finance the technical manual contract. Moreover, with respect to the *amount* of such partici-

pation, plaintiff's activities more than encompassed the funds at issue in the present action.

First, plaintiff's participation extended *at least* as far as the sums loaned pursuant to the refinancing. At the time plaintiff entered into the refinancing arrangement, Franklin had called the loans to Trilon. Trilon's sole business was directed toward Government contract work. If Trilon had been forced to pay its $52,812 debt, these funds (if available at all) would have been withdrawn from Government contract projects. When plaintiff paid Franklin the $52,812, it was as effectively assisting Trilon's completion of the Government contracts as the sums had been directly advanced after a Trilon loan repayment to Franklin. Plaintiff meets the "participation in the financing" requirement *at least* in the amount of the funds paid pursuant to the refinancing.

Second, and more important, plaintiff had already advanced more than $250,000 directly to Trilon in prior years to assist completion of Government contracts. Presumably plaintiff had a right to call these loans at any time. Trilon, both at the time of the $250,000 loan and later up through the refinancing, was engaged in Government contract work. Therefore, we again must look, not to a single contract, but to the overall Government benefit in ascertaining whether or not plaintiff's loans to Trilon *before* the refinancing operate to meet the "participation in the financing" requirement.

It is clear that by the time of the refinancing, Trilon was in financial difficulties. Having loaned over $250,000 to Trilon, plaintiff stood in a position to foreclose its loans. In such event, Trilon's Government contract work might have been halted. In such a situation, the goal of the Act, to encourage completion of Government contracts, would have been thwarted. Therefore, in order to effectuate the purposes of the Act, we hold that the "participation in the financing" requirement is met not only to the extent of funds advanced at the time of a given assignment or reassignment, but also in the amount of funds previously furnished to assist completion of Government contracts. In the case at bar, plaintiff meets the "participation" condition, both with respect to the $52,812 loaned during the refinancing *and also* from the prior advancements exceeding $250,000.

Plaintiff may use the set-off protections on the entire $54,369.37 at issue in the instant action because it meets the test for having participated in the financing of Government contracts in an amount far exceeding the sums at issue here.

VII

Government Contract Financing:

We have repeatedly emphasized throughout this opinion that the set-off protection provisions of the Act and the ASPRs must be interpreted in a manner to effectuate the overall purpose of Congress:

> [T]o facilitate the financing of Government contracts by private capital in the way in which private capital normally operates in financing the country's economy. [*Chelsea Factors*, *supra*, 149 Ct. Cl. at 210, 181 F. Supp. at 690].

Plaintiff argues, and we agree, that any other result than the one we have reached in the instant case would detract from this goal.

In its reply brief, plaintiff illustrates a five-chambered house of horrors which it claims would result from a decision in defendant's favor.[19] Defendant fails to answer plaintiff's argument, saying that each case must be decided on its own merits. While, of course, each case is confined to its particular facts, this does not mean that the court is forced to put on blinders. A key factor in any decision is the potential ramification of the result. A court must be particularly cognizant of the implications of a given case in the situation where it is confronted with clear evidence of legislative intent and

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[19] Plaintiff gives five vivid examples of situations which would result from a decision in defendant's favor. In such instances, financing of Government contracts would *not* operate in a normal manner. A good example is plaintiff's second illustration.

> [A] Government contractor has a number of Government supply contracts which provide a regular, steady income. It has just entered into an agreement with the Government which will require it to construct a plant * * *. [Under defendant's arguments in the instant case] it may not pledge the equity in the * * * supply contracts * * * in order to raise the money for necessary expenditures on the * * * new Government contract.

Thus defendant's narrow interpretation of the Act which would lead to the situation given in plaintiff's example would not allow for financing of Government contracts in the manner in which private capital normally operates. Such a result would certainly conflict with Congressional intent in passing the amendments to the Act.

must formulate an application of the statute which furthers such Congressional purpose.

In the present action we have construed the amendments to the Assignment of Claims Act to give effect to the intent of Congress. Our construction should facilitate the financing of Government contracts by encouraging investment of private capital in a normal manner. Any holding involving the instant facts could do no less.

VIII

Interest:

In addition to its claim for $54,369.37 free of defendant's set-offs, plaintiff's petition seeks recovery of accrued interest. Defendant counters that if plaintiff's recovery is based on subrogation, we cannot award interest to plaintiff because Franklin's right to receive interest terminated at the time of the refinancing.[20] However, neither plaintiff nor defendant focus on the interest question in any detail in their arguments.

Initially, we note that plaintiff is not entitled to recover interest on a claim against the Government absent a showing that it held a right to collect interest under a statute or contract so providing. This requirement is based both on statutes and case law. 28 U.S.C. § 2516 provides:

> Interest on a claim against the United States shall be allowed in a judgment of the Court of Claims only under a contract or Act of Congress expressly providing for payment thereof. [28 U.S.C. § 2516(a) (1970)].

See also Judge Skelton's excellent analysis of Supreme Court and Court of Claims decisions in *United States* v. *Mescalero Apache Tribe*, 207 Ct. Cl. 369, 518 F. 2d 1309 (1975), *cert. denied*, 425 U.S. 911 (1976).

In the instant case plaintiff has cited no statute or contract provision which would entitle it to interest on a judgment in its favor. Normally, we would be forced to deny such interest claims. However, defendant seems to concede that Franklin held a right to receive interest on the technical

[20] Defendant fails to discuss the question of an interest award in the event we hold for plaintiff as a beneficial reassignee. We assume that since plaintiff's rights to receive interest are equally derivative, either as a beneficiary or as a subrogee, its entitlement to interest would be the same in either event.

manual contract proceeds. It says that such right terminated at the time of the refinancing. Unhappily, we do not have the specific provisions of the technical manual contract before the court, other than those dealing with the assignments.

As discussed in Parts IV and V, *supra*, plaintiff has succeeded to Franklin's rights against defendant. Such derivative rights are not obliterated by the fact that plaintiff paid Franklin during the refinancing. *See* Part V, *supra*. Thus if Franklin held a right to receive interest, plaintiff would step into Franklin's shoes and would be entitled to recover interest in the present action. The only problem is that from the present state of the record we cannot ascertain Franklin's rights to obtain interest under the technical manual contract. Where the evidence before the court is not meaningfully correlated to an ultimate issue in the case, summary judgment cannot be granted on such issue and a remand to the trial judge for further proceedings is required. *Cheyenne-Arapaho Tribes* v. *United States*, 206 Ct. Cl. 340, 353, 512 F. 2d 1390, 1397 (1975).

Accordingly, we must remand the issue of interest to the trial judge for a determination of plaintiff's derivative entitlement based on rights held by Franklin. Should it appear from additional evidence that Franklin could recover interest on the technical manual contract proceeds, plaintiff will be entitled to receive interest on the instant claims, either as beneficiary or as subrogee.

In summary, plaintiff comes before the court seeking to recover $54,369.37 (plus interest) free of defendant's independent set-off claims as assignee of certain Government contract rights. Plaintiff has standing to use the set-off protection provisions of the Assignment of Claims Act, the ASPRs and the contract because it may sue on the contract at issue, either as beneficiary of a 1971 refinancing transaction or as subrogee of the original contract assignee (Part IV). Plaintiff's entitlement to the set-off protections extends to encompass the entire $54,369.37 at issue (Part V). Plaintiff may use the protections because it has effectively participated in the financing of Government contracts (Part VI). Finally, our construction of the Act is in complete accord with the intent of Congress to promote the financing of Gov-

ernment contracts (Part VII). We remand the interest issue to the trial judge in order to receive additional evidence (Part VIII). Our decision will, of necessity, cost defendant at least $54,369.37 in the instant case. However, the enhancement to competitive bidding which should result from an additional availability of capital should prove to create a far greater Government savings in the years to come.

Accordingly, for the reasons stated above, plaintiff's motion for summary judgment is granted in part and denied in part and defendant's cross-motion for summary judgment is denied. Plaintiff is entitled to recover $54,369.37 free of defendant's independent set-offs and judgment is entered to that effect. The interest issue is remanded to the Trial Division for further proceedings consistent with this opinion.

DAVIS, *Judge*, concurring in part and dissenting in part:

I slice this case differently. Although my result in figures is not too far from the court's, I reject the over-broad reading of "participating in such financing" in the Assignment of Claims Act of 1940 (*see* Part VI of the court's opinion), and would confine that concept to a lender whose loan was used, or was available for use, in financing the particular government contract under which suit is brought. Admittedly, the plaintiff's loan to Trilon was not used and was not available—and could not be—for the technical manuals contract on which this suit is founded since that agreement was fully performed about a year (1968) before First National City Bank even undertook to finance Trilon (1969).[1]

I reach this interpretation on both the text and the purpose of the statute. The 1940 Assignment of Claims Act is entirely written in terms of a single government contract which is being financed by a lender or group of lenders, not in the government-wide terms of which the court speaks. The statutory concept is that of financing a specific government contract, not of the financing of government contracts in general or across-the-board, or the financing of all of a con-

[1] First National had nothing to do with the technical manuals contract until September 1971 when it paid off Franklin which had an assignment of the proceeds of the contract.

tractor's contracts as a lump. The immediate context of the phrase "participating in such financing" relates to the financing of the particular contract on which the statutory provision centers; grammatically and naturally, "such" refers back to the financing of that particular contract and "financing" likewise refers to the financing of that individual contract, not other contracts of the same contractor or contracts generally. It is, of course, too much of a strain to think of plaintiff as financing the technical manuals contract, all the work on which was done and finished a year before First National came into Trilon's world.[2]

The objective of the 1940 Act was to authorize the financing of individual government contracts in the sense that Congress wished the holder of such a pact to be free to receive financial help in performing his agreement in reliance on the security of the expected government payments from that contract. At the same time Congress did not, I think, wish to eat into the Government's normal right of setoff against the assignor more than would be necessary to induce such monetary aid in performing. Where a contract has been fully completed, further aid is not needed for that contract and there is no occasion to give up the right of setoff. "The Act was designed to make funds available to a contractor with which he could *complete his government contract.* If the loan is used for another purpose [here, that must be so since Trilon had already completed the technical manuals contract], the objectives of the Act are not satisfied." *Coleman* v. *United States*, 158 Ct. Cl. 490, 496 (1962) (emphasis added).

This view does not mean that loans must be tied to particular contracts nor does it go counter to the endorsement of the revolving-credit plan in *Continental Bank & Trust Co.* v. *United States*, 189 Ct. Cl. 99, 416 F. 2d 1296 (1969). In all of our prior cases, including *Continental Bank*, which have upheld the financing institutions' right to recover free of setoffs, the loans were made before the completion of the particular contract and were available to help in the performance of that work—even though the loans may not have

[2] The contract clause in the technical manuals agreement and the ASPR regulations do not deviate from the statute.

been tied to, or designated as directed to, a or the specific contract. The same is true of the "five-chambered house of horrors" plaintiff has included in its brief; with the exception of one-half of one of the five examples, in all those situations the loan is and can be available for all non-completed government contracts of that contractor-borrower, and therefore the financial institution can avail itself of the right of recovery free of setoff. It is only where the contract has been fully performed before the loan is made [3] that the institution cannot call upon that right under that particular contract. The reach of that rule would thus not be nearly as wide as the court and plaintiff assert. On the other hand, it should be noted that the court's broader view would allow a setoff-free recovery by plaintiff under the technical manuals contract even though that bank had refused to pay Franklin off in 1971, and although the contract had been fully performed a decade before First National had any dealings with Trilon.[4]

For these reasons, I would hold that plaintiff does not belong within the class of those "participating in such financing" under the 1940 Act. Nor is the First National Bank a proper reassignee under the Act and the contract clause. Franklin refused in 1971 to release its own prior assignment and on that ground the Government would not accept the attempted reassignment to First National. If one thing is clear under the statute and the clause, it is that, with respect to any individual contract, there can be only one assignee at a time (with the exception, which as shown above I consider inapplicable, of other parties "participating in such financing"). Since Franklin insisted on retaining its own assignment, plaintiff could not take over directly under the Act.

All this leads me to conclude that First National has no claim under the Assignment of Claims Act of 1940. But plaintiff also puts itself forward, apart from that statute, as the subrogee of Franklin which it paid off in 1971. To the extent

[3] And perhaps where the loan agreement explicitly forbids use of the loan on a specific contract.

[4] Unfortunately, it is not unknown that claims under a contract take ten years or more to proceed through the administrative and judicial processes.

of the payments made by plaintiff to Franklin at that time, I agree with the court, partly for the reasons it gives, that First National was subrogated to Franklin's rights under the latter's assignment. Plaintiff was not a volunteer and it succeeded to those rights Franklin would have had if it had not been paid off. As the court shows, the general principles of "common-law subrogation" are met.

Defendant's response is that to recognize subrogation here would subvert the limitations of the old anti-assignment part of the Assignment of Claims Act. The majority counter this suggestion by finding that the conditions of the 1940 Act are themselves satisfied. I cannot take that road since I believe, as discussed above, that plaintiff is unable to shield itself under the coverage of the 1940 legislation. But I find my answer in the proposition that, on the facts here, there is no contradiction of the aims of the original, historic anti-assignment law in allowing this plaintiff to recover as subrogee. The statutory purposes of that old legislation are to prevent fraud, control multiple litigation, and confine the government's dealings to a very limited number of persons or entities. In this particular instance, the Government, before the suit was brought, had already elected to deal with plaintiff with respect to the technical manuals contract. As the court's opinion points out, defendant sent a copy of the agreement resolving the dispute (over additional compensation on the technical manuals contract) not to Franklin or the Small Business Administration but to plaintiff; the defendant also haggled with plaintiff over whether the latter should have priority before any setoff; and the GAO appears in effect to have determined that First National was at least entitled to $7,812 without any setoff. Thus, by its own choice defendant treated First National as an interested party. Where that has happened it seems to me an unwholesome technical rigidity to apply the principles underlying the pre-1940 anti-assignment statute to lock the barn after the horse has deliberately been let out by the Government's own officials.

I would therefore allow plaintiff to recover that part of the monies it paid to Franklin in 1971 which it has not yet recovered. On the interest issue, I agree with the court.

Syllabus

536 F. 2d 1361

INTERNATIONAL TELEPHONE AND TELEGRAPH CORPORATION AND INTERNATIONAL STANDARD ELECTRIC CORPORATION v. THE UNITED STATES AND RIDGE ELECTRONICS CORPORATION, TEXAS INSTRUMENTS, INC., AND SPERRY RAND CORPORATION, THIRD-PARTY DEFENDANTS

[No. 263–73. Decided June 16, 1976]

OPINION

Patents; limitation of actions; tolling of limitations; viability of Sec. 3 of the Royalty Adjustment Act; Emergency Powers Continuation Act.—This phase of a suit for alleged patent infringement is before the Court for review of an opinion of the trial judge, and concerns whether, as a result of plaintiffs' filing of an administrative claim with the Federal Aviation Administration and/or the Coast Guard, defendant's liability for procurement should extend back, in addition to the 6 years provided by 28 U.S.C. § 2501, for an additional 6 years pursuant to 35 U.S.C. § 286. Resolution of that question depends upon whether those agencies had authority under Sec. 3 of the Royalty Adjustment Act (RAA) to administratively settle claims of infringement. Defendant contends, *inter alia*, that the Act was repealed by the Emergency Powers Continuation Act (EPCA), Pub. L. 450, that Title 35 of the Code in its present form is a positive statement of the law, and that the absence therefrom of Sec. 91 (Sec. 3 of the RAA) is conclusive of the lack of effectiveness since July 1, 1953 of Sec. 3. In view of the legislative history of the EPCA, including reports of the committees of the House and Senate and other legislation, it is *held* that Congress did not intend to repeal and did not repeal 35 U.S.C. § 91. The trial judge's opinion and conclusions of law that the agencies in question had the authority at the time of plaintiffs' negotiations to settle claims under Sec. 3 and that 35 U.S.C. § 286 is applicable, are affirmed and adopted as the opinion of the court. Defendant's request for review is denied and the case is remanded to the trial judge for further proceedings.

Statutes; construction and operation; ambiguity.

[1] Federal courts have allowed the expressed intention of Congress to prevail over the alleged plain-meaning of a statute in cases involving a statutory ambiguity.

Statutes ⟸ 181(1)

Patents; limitation of actions; tolling of statute; infringement claim.

[2] 35 U.S.C. § 286 tolls the 6-year limitation on damages for infringement of a patented invention for a period of up to 6 years between the filing of a claim for compensation with a Government

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department or agency having authority to settle such a claim and the date of denial thereof.

Patents ⟸ 268

Patents; Royalty Adjustment Act of 1942, current Section 3 status.

[3] Sections 3–8 of the Royalty Adjustment Act of 1942 (35 U.S.C. §§ 91–96 (1946 ed.)) are permanent provisions which were not repealed by the Emergency Powers Continuation Act, Pub. L. 450, 92d Cong., 2d Sess. As a result, the Federal Aviation Administration and/or the Coast Guard had authority at the time of plaintiffs' negotiations to settle administratively the subject claims of infringement. The application of the statute of limitations to plaintiff's claim, therefore, is tolled by 35 U.S.C. § 286.

Patents ⟸ 268

Statutes; construction and operation; Emergency Powers Continuation Act, Pub. L. 450; legislative intent; Royalty Adjustment Act of 1942.

[4] The legislative history of the Emergency Powers Continuation Act, Pub. L. 450, gives no indication that Congress intended to use the law as a vehicle to repeal permanent legislation generally and 35 U.S.C. §§ 91–96 (1946 ed.) in particular. Rather, the obvious intent of Congress was to continue for a temporary period wartime measures which would have expired as a result of signing of the Japanese Peace Treaty.

War and National Defense ⟸ 36

Statutes; construction and operation; repeals; repeal by implication.

[5] It is a cardinal principle of statutory construction that repeals by implication are not favored. The intention of the legislature to repeal must be clear and manifest. Except in cases of clear repugnancy between an earlier and a later statute, the later statute will not be deemed to have repealed the earlier, but effect should be given to both if possible.

Statutes ⟸ 161(1)

Statutes; construction and operation; code and statute; conflict between.

[6] The United States Code is only a *prima facie* statement of the statute law, and where the Code and the Statutes at Large are inconsistent, the Statutes at Large must prevail. The fact that the codifiers failed to include 35 U.S.C. §§ 91–96 (1946 ed.) in the 1952, 1958, 1964 and 1970 editions of the United States Code is of no legal significance where said sections were passed as permanent legislation and have not been expressly or implicitly repealed.

Statutes ⟸ 231

Statutes; construction and operation; dormancy of statute.

[7] The fact that a statute has lain dormant for many years does not diminish its present force. Thus, the failure of the Commission on Government Procurement to recognize the existence of 35 U.S.C.

§ 91 is of no moment and cannot be accepted as evidence of its expiration.

Statutes ⇐ 231

Paul M. Craig, Jr., attorney of record, for plaintiffs; *Melvin Kraus*, of counsel.

Robert H. Plotkin, with whom was *Assistant Attorney General Rex E. Lee*, for defendant; *Vito J. DiPietro*, of counsel.

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and KASHIWA, *Judge*.

PER CURIAM: This case comes before the court on defendant's request for review, pursuant to Rule 53(c)(3), of the opinion of Trial Judge Colaianni on the issue as to whether the application of the statute of limitations to plaintiffs' claim is tolled by 35 U.S.C. § 286. Upon consideration of the briefs and arguments of counsel, the court agrees with the trial judge's opinion, but we add the following:

In cases involving a statutory ambiguity similar to the one involved in this case, federal courts have allowed the expressed intention of Congress or a state legislature to prevail over the alleged plain-meaning of a statute. *See Southeastern Financial Corp.* v. *Smith*, 397 F. Supp. 649 (D. Ala. 1975); *Fleming* v. *Salem Box Co.*, 38 F. Supp 997 (D. Ore. 1940).[1]

In *Fleming*, the court refused to accept at face value a specific reference in section 17 of the Fair Labor Standards Act of 1938 to section 20 of the Anti-Trust Act. After examining the legislative history of the Fair Labor Standards Act, the court concluded that

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[1] *See also Ronson Patents Corp.* v. *Sparklets Devices, Inc.*, 102 F. Supp. 123 (E.D. Mo. 1951). In *Ronson*, the defendant had moved to dismiss a patent infringement suit on the ground that a private act of Congress extending plaintiff's patent for seven years was ineffective because the act had incorrectly specified the reissue date of the patent as "December 12, 1923." The correct date of reissue was December 12, 1933. In denying defendant's motion, the court observed that:

"Mere verbal inaccuracies, or errors in statutes in the use of words, numbers, grammar, punctuation, or spelling, will be corrected by the court, whenever necessary to carry out the intention of the legislature as gathered from the entire act. If the legislative intent is clear, it must be given effect regardless of inaccuracies of language. [102 F. Supp. at 124; *accord*, J. Sutherland, *Statutory Construction* § 47.37 (4th ed. Sands 1973).]"

a mistake was made in the substitution of the figures and that the intention was to refer to Section 17 of the Anti-Trust Act. A palpable clerical error clearly shown should not override legislative intention. [38 F. Supp. at 998.]

In *Southeastern Financial Corp.* v. *Smith*, *supra*, an assignee of the accounts receivable of a carpet seller brought an action against an individual who signed a check given in payment of an account of a corporate carpet purchaser. Any recovery by the plaintiff had to be under a particular Alabama state law enacted in 1959 as "Act 567." After its enactment, Act 567 had been unofficially codified at Title 39, § 53 (1) of the Alabama Code. Subsequently, when the Alabama legislature adopted the Uniform Commercial Code, it purported to repeal, *inter alia*, "Title 39, §§ 1–12, inclusive, § 13, as amended, §§ 14–85, inclusive * * *." 397 F. Supp. at 654. The court observed that, on its face, this reference would seem to include Act 567. However, since no act of the Alabama legislature had been officially codified since the Alabama Code of 1940, the court concluded that

> all references in subsequent acts to Code provisions must be construed as applying only to the Code as it was codified in 1940, not as it might have been [unofficially] recompiled or recodified by the Code publisher. Thus, an act passed subsequent to the adoption of the Code of 1940 could be repealed only by specific reference to the act by number and year of adoption. That this is the understanding of the Alabama Legislature may be inferred from the repealing provision cited above, since the provision specifically repeals, in addition to the recited Code sections, a number of acts adopted subsequently to the 1940 Code. These later acts are repealed by reference to the act number and year of enactment. Therefore, it would stretch the legislature's intent to view the repeal of "§§ 14–85, inclusive," as repealing Act 567.
>
> Nor can it be inferred that this act was repealed by implication. This is a disfavored method of appeal [sic], and "[i]t is only when two laws are so repugnant to or in conflict with each other that it must be presumed that the Legislature intended that the latter repealed the former." *City of Birmingham* v. *Southern Express Co.*, 164 Ala. 529, 538, 51 So. 159, 162 (1909). Since the UCC provides contractual remedies while the statute here provides a tort remedy, there is no reason to assume that

the legislature intended to repeal the latter by adoption of the UCC. [397 F. Supp. at 654.]

We conclude, therefore, that the legislative history, including the reports of the committees of the House and Senate, and the express language of Pub. L. 313, H.J. Res. 423, 82d Cong., 2d Sess.—all as set forth in the trial judge's opinion—demonstrate that Congress did not intend to repeal, and did not repeal, 35 U.S.C. § 91 by the enactment of Pub. L. 313 or the other Acts relied upon by defendant. Accordingly, the trial judge's opinion and conclusions of law are hereby affirmed and adopted as the opinion of the court; defendant's request for review is denied, and the case is remanded to the trial judge for further proceedings.

OPINION OF TRIAL JUDGE

COLAIANNI, *Trial Judge:* By motion of June 26, 1974, plaintiffs sought a separate trial on the issue of tolling of the time limitations on damages or, in the alternative, for a trial on additional infringements during a period more than 6 years prior to the filing of the petition. Plaintiffs' motion points out that the parties disagree on the applicability of 35 U.S.C. § 286 to the present case.

Section 286 of Title 35 U.S.C. tolls the 6-year limitation on damages for infringement of a patented invention for a period of up to 6 years between the filing of a claim for compensation with a department or agency of the Government that has authority to settle such claim and the date of denial of that claim.

Plaintiffs argue, in the numerous papers filed in support of their motion, that defendant's liability for procurement is not limited by 28 U.S.C. § 2501 to the 6 years immediately preceding the filing of their August 14, 1973, petition, but rather that the accounting period should extend back an additional 6 years because of plaintiffs' filing of an administrative claim with the Federal Aviation Administration (hereinafter referred to as "FAA") and/or the Coast Guard.

Defendant, in the various papers it has filed in opposition to plaintiffs' motion, argues that the FAA and the Coast Guard, now agencies of the Department of Transportation,

did not have authority to settle administrative claims for patent infringement at the time of plaintiffs' "negotiations" with them.

Plaintiffs contend, to the contrary, that section 3 of the Royalty Adjustment Act of 1942 (hereinafter referred to as the "RAA") gives all departments and agencies of the Government the authority to settle claims arising out of the use of patented inventions. Plaintiffs thus urge that section 3 of the RAA authorized administrative settlement of claims between them and the FAA and/or the Coast Guard. Plaintiffs further contend that the years spent in attempting to settle their claims with the above agencies, up to 6 years, should, in accordance with the letter and spirit of 35 U.S.C. § 286, be tacked on to the 6-year accounting period defined by 28 U.S.C. § 2501.

While it appears at first blush that the question of whether or not plaintiffs' settlement discussions tolled the application of the 6-year time limitation on damages established by 28 U.S.C. § 2501 could be deferred to an accounting trial following the establishment of defendant's liability, plaintiffs point to the fact that different accused structures were purchased by defendant during the period immediately preceding August 14, 1967, from those after that date. Thus, different proofs will have to be submitted at trial to prove plaintiffs' claims of infringement for the 12-year period prior to the filing of their petition in this court. If the statute of limitations were not tolled, however, the procurement prior to August 14, 1967, would be of no moment and thus irrelevant to the pending litigation. Accordingly, it becomes necessary to establish whether or not the FAA and/or the Coast Guard had authority to settle administratively claims of infringement at the time of plaintiffs' negotiations.

Defendant raises a number of arguments to refute plaintiffs' contention concerning the present viability of section 3 of the RAA. The more serious of these are that:

> 1. The entire RAA was intentionally included in the * * * [Emergency Powers Continuation Act, hereinafter referred to as the "EPCA"] although drafts thereof, Executive Branch requests therefor, and the Interim EPCA included only Sections 1 and 2 thereof.

2. The legislative history of the EPCA and of the EPCA extensions show that the effect of Section 1(a) of that law was to repeal those statutes listed therein.

* * * * *

5. Title 35, U.S. Code is a positive statement of the law and the absence therefrom of Section 91 is conclusive of the lack of effectiveness since July 1, 1953 of RAA Section 3.

* * * * *

8. The Government Procurement Commission, the editors and compilers of the U.S. Code and the U.S. Code Annotated, and the Comptroller General were all correct in their opinions that:

a. There is a lack of authority to administratively settle claims for patent infringement in Government agencies other than the Defense Department, and

b. The Royalty Adjustment Act, 35 U.S.C. (1946 ed.) §§ 89–96, expired on July 1, 1953.

As explained hereinbelow, defendant's arguments are found to be unpersuasive, and it is concluded that 35 U.S.C. §§ 91–96 (1946 ed.) is permanent legislation which was not repealed by the Emergency Powers Continuation Act, Pub. L. 450, 82d Cong., 2d Sess.

Background

The Royalty Adjustment Act of 1942, containing sections 1–10, was enacted as Pub. L. 768 during the 77th Congress. Sections 1 through 8 of that act were later codified as 35 U.S.C. §§ 89–96 (1946 ed.). Sections 9 and 10, the act's savings clauses, were included by a note following § 89.

Sections 89 and 90 of Title 35 provided that an agency was to inform a licensor whenever its head found that a patented or unpatented invention was being manufactured, used or sold for the United States under a license calling for the payment of royalties which he believed to be excessive. The head of the agency could then call a hearing and by order fix the royalties deemed to be fair. The licensor's sole remedy was a suit to recover the difference between the royalties fixed and specified by the agency and the royalties found by the court to be fair and just compensation for the

manufacture, use, sale, or other disposition of the licensed invention for the United States.

Section 91 of 35 U.S.C., formerly section 3 of the RAA, provides:

> § 91. *Adjustment of royalty rates; settlement and compromise of claims against the United States*
>
> The head of any department or agency of the Government which has ordered the manufacture, use, sale, or other disposition of an invention, whether patented or unpatented, and whether or not an order has been issued in connection therewith pursuant to section 89 of this title, is authorized and empowered to enter into an agreement, before suit against the United States has been instituted, with the owner or licensor of such invention, in full settlement and compromise of any claim against the United States accruing to such owner or licensor under the provisions of sections 89–96 of this title, or any other law by reason of such manufacture, use, sale, or other disposition, and for compensation to be paid such owner or licensor based upon future manufacture, use, sale, or other disposition of said invention. (Oct. 31, 1942, ch. 634, § 3, 56 Stat. 1014.)

Another section relevant to the question at bar, 35 U.S.C. § 95, clearly indicates that 35 U.S.C. §§ 89 and 90 was to remain in force "* * * only during the continuance of the present war [World War II] and for 6 months after the termination thereof * * *." No such limitation is provided for the remaining sections. Thus, plaintiffs argue that 35 U.S.C. § 91 is permanent legislation which is in full force and effect to this date.

Defendant, on the other hand, points to the Emergency Powers Continuation Act, Pub. L. 450, 82d Cong., 2d Sess., which provided that each of the statutory provisions particularly delineated in that law was to remain in full force and effect to April 1, 1953.[1] Among the statutory provisions included in Pub. L. 450 was: "act of October 31, 1942 (ch. 634, 56 Stat. 1013; 35 U.S.C. 89 and note and 90–96) * * *." Defendant thus argues that Pub. L. 450 established an expiration date for the entire Royalty Adjustment Act and not

[1] Extended to July 1, 1953, by Pub. L. 12, 83d Cong.

only §§ 89 and 90 thereof. Because of the apparent ambiguity which exists between Pub. L. 450 and 35 U.S.C. §§ 89 and note and 90–96 (1946 ed.), it becomes necessary to review the legislative history leading up to the passage of Pub L. 450 to establish its true intent and purpose.

In early 1952, this country was engaged in the Korean police action and President Truman depended upon power granted under a number of wartime laws for authority to perform certain necessary acts in furtherance of that action. Japan was the last country with which the United States was still technically at war, and thus a whole host of wartime laws continued to exist only because a peace treaty between Japan and the United States had not been signed. However, for a variety of reasons, this country in early 1952 was eager to sign a treaty of peace with Japan. As a result, the existence of several hundred wartime laws would have terminated, either immediately or within 6 months, following the signing of a peace treaty with Japan.[2]

The imminent signing of a peace treaty with Japan to officially terminate all World War II hostilities, coupled with the necessity of the President to continue exercising the powers permitted by these temporary statutory provisions during the Korean police action, prompted President Truman on February 19, 1952, to send a draft of a proposed joint resolution entitled: "A joint resolution to continue in effect certain statutory provisions for the duration of the national emergency proclaimed December 16, 1950, and 6 months thereafter, notwithstanding the termination of the existing state of war" to the Speaker of the House. The communication [3] specifically stated:

> My Dear Mr. Speaker: I transmit herewith a draft Emergency Powers Continuation Act, recommended by the Secretary of Defense, the Attorney General, the Chairman of the National Security Resources Board, and the Director of the Bureau of the Budget, and I recommend immediate and favorable consideration of it by the Congress.

[2] The peace treaty with Japan was signed on April 28, 1952.
[3] H.R. Doc. No. 368, 82d Cong., 2d Sess. 1 and 2 (1952).

Opinion of Trial Judge

> The purpose of this draft bill is to insure the continuation of certain specific powers which the Government is exercising for the preservation of the national security. Under the language used in the statutes conferring these powers they exist now only because we are still technically in a state of war. The only state of war still existing between this country and others is the state of war with Japan. Accordingly, unless the Congress acts to continue these powers they will end when that state of war ends or, in some cases, within a fixed period thereafter. The consideration of this measure is a matter of urgency since the treaty of peace with Japan has now been favorably acted on by the Senate Committee on Foreign Relations. * * *
>
> The bill is based on an intensive study of Federal law, which took account of legislation enacted up to the close of the last session of Congress and even during the present session. But a limited purpose has guided the drafting. That purpose is to deal, in this bill, only with such of the war-dependent authorizations now existing as should be continued in the interest of national security during a period when disturbance in world affairs makes it necessary to exercise unusual powers. * * *

The following explanation[4] contained in an enclosure from the National Security Resources Board which accompanied President Truman's communication similarly attests to the concern that Congress continue legislation which was about to expire because of the signing of a peace treaty by the United States and Japan:

> * * * It [the working group] first prepared a list of statutes, to include all existing statutory authorizations which would terminate upon the termination of the war with Japan, or the 1939 and 1941 emergencies, or at a fixed time thereafter. * * * The list of statutes was then circulated by the Bureau of the Budget with a covering memorandum which explained the assumptions on which it had been prepared and requested the agencies to give the Bureau their reasoned views as to which statutory authorizations set forth in the list should be continued after the termination of the war with Japan. The agencies were also requested to point out and make recommendations on any other existing war-dependent authorizations affecting them.

[4] H.R. Doc. No. 368, 82d Cong., 2d Sess. 4 (1952).

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The draft bill and explanatory material [5] which accompanied President Truman's February 19, 1952, letter to Speaker of the House Rayburn provided in pertinent part:

> Whereas the existing state of war with Japan is the last declared state of war to which the United States is a party and the termination thereof and of the national emergencies proclaimed in 1939 and 1941 would render certain statutory provisions inoperative; and
>
> Whereas some of these statutory provisions are needed to insure the national security and the capacity of the United States to support the United Nations in its efforts to establish and maintain world peace: Now, therefore, be it
>
> *Resolved by the Senate and House of Representatives of the United States of America in Congress assembled:*
>
> SECTION 1. Notwithstanding the termination hereafter of the war with Japan declared December 8, 1941 (55 Stat. 795), and of the national emergencies proclaimed by the President on September 8, 1939 (Proclamation 2352, 54 Stat. 2643), and on May 27, 1941 (Proclamation 2487, 55 Stat. 1647), and notwithstanding any proclamation of peace with respect to such war:
>
> (a) The following statutory provisions shall remain in full force and effect until six months after the termination of the national emergency proclaimed by the President on December 16, 1950 (CFR, 1950 Supplement to title 3, p. 71) or until such earlier date or dates as the Congress by concurrent resolution either generally or for a particular statutory provision or the President either generally by proclamation or for a particular statutory provision may provide, any other terminal date or provision of law with respect thereto to the contrary notwithstanding:
>
> * * * * *
>
> (33) Act of October 31, 1942, chapter 634, sections 1 and 2, 56 Statutes 1013 (35 U.S.C. 89, 90).
>
> * * * * *

Thus, it appears relatively clear that the draft bill proposed by President Truman only intended to deal with a small number of wartime provisions, including the royalty adjustment sections, 35 U.S.C. §§ 89–90, of the RAA.

Moreover, to emphasize the fact that President Truman only wanted Congress to extend the war-dependent sections

[5] H.R. Doc. No. 368, 82d Cong., 2d Sess. 5–6 (1952).

of the RAA, 35 U.S.C. §§ 89–90, which by the terms of 35 U.S.C. § 95 would expire by the signing of the peace treaty with Japan, the explanation accompanying the draft bill provided:[6]

> The draft Emergency Powers Continuation Act extends the life of about 60 specific statutory authorizations which, in the absence of action by Congress, would terminate upon the termination of the present state of war with Japan or of the national emergencies proclaimed by the President in 1939 and 1941, or, in some cases, within a fixed period thereafter. The bill provides, generally speaking, that these authorizations shall continue in effect until 6 months after the termination of the national emergency proclamed by the President in 1950 or until earlier dates fixed by concurrent resolution of the Congress or by the President. Each provision affected by the bill is explained herein, with a short caption, a digest, and a brief justification of the action proposed. The statutory language referring to war or emergency is set forth in quotation marks and italics.
>
> The bill may be summarized as follows:
>
> Section 1(a) deals with certain provisions conferring authority in time of war or during the present war or the 1939 or 1941 national emergencies. These provisions are continued in effect.

The report went on to indicate that only §§ 89 and 90 were being considered. The report particularly provided:[7]

> These sections provide authority for requiring the return to the Government of an amount representing the difference between royalty returns based upon prewar periods of normal production and those which would be appropriate to the expanded production caused by war. They are effective "*during the continuance of the present war and for 6 months after the termination thereof*" (35 U.S.C. 95).
>
> In view of the current substantial increases in military procurement and the prospect that the national economy is facing a period of expanded production for military purposes, the continuation of this law is essential if the Government is to be protected against exces-

[6] H.R. Doc. No. 368, 82d Cong., 2d Sess. 10 (1952).

[7] H.R. Doc. No. 368, 82d Cong., 2d Sess. 23 (1952), para. 33, *Adjustment of Royalties for Use of Inventions in Aid of Prosecution of the War* (35 U.S.C. 89, 90).

sive increases in patent royalties originally based upon returns appropriate to periods of normal production. Legislation to make this wartime statute permanent law is being sponsored by the Department of Justice with the active support of the Department of Defense (H.R. 2257).

The Presidential communication occasioned a series of Senate and House joint resolutions, some of which resulted in Public Laws that are relevant to this inquiry with regard to the RAA. A brief discussion of the more pertinent resolutions and Public Laws follows.

On February 20, 1952, H.J. Res. 386, an exact copy of the draft bill proposed by President Truman's February 19, 1952, communication, was introduced before the 2d Session of the 82d Congress. Subcommittee hearings on this resolution were held on February 27, 28, 29; March 6, 7, 12, 13, 21, 24, 26, 28; and April 2, 7, 25, 28, 1952. The testimony of Robert S. Milans, Contract and Royalty Negotiations Branch, Patents Division, Department of the Navy, given on March 21, 1952, is the only portion of the hearings that in any way relates to the RAA. That testimony clearly indicates that only 35 U.S.C. §§ 89–90 was being considered by the committee.

On March 3, 1952, S.J. Res. 139 was introduced. This resolution was the first introduced in the Senate and thus is presumed to mirror the draft bill proposed by President Truman.

During the pendency of H.J. Res. 386 and S.J. Res. 139, and particularly during April of 1952, H.J. Res. 423 and S.J. Res. 148 were introduced. However, whereas the previous resolutions were directed at continuing the temporary statutory provisions identified in President Truman's draft bill until 6 months after termination of the national emergency proclaimed by President Truman on December 16, 1950, the latter resolutions sought to continue the effectiveness of the temporary statutory provisions until July 1, 1952. The reason for what may appear to be a duplication of efforts was the failure of Congress to pass legislation to continue the President's emergency powers since his February 19, 1952, request.

The possibility that a peace treaty with Japan would be signed during the approaching Congressional Easter recess prompted President Truman to request, in an April 7, 1952, letter to the Speaker of the House, Sam Rayburn, to "* * * extend for a period of 60 days emergency powers which otherwise will terminate when the treaty of peace with Japan becomes effective."

S. Rep. No. 1451, 82d Cong., 2d Sess., dated April 8, 1952, refers to President Truman's April 7, 1952, message and recommends passage of S.J. Res. 148 (which corresponded to H.J. Res. 423) to temporarily extend until July 1, 1952, certain statutory provisions. Attached to the report was a memorandum prepared by the Bureau of the Budget that classified, according to subject matter, the statutory provisions dealt with in the proposed Emergency Powers Continuation Act. The memorandum, by using the same paragraph designation used in President Truman's draft bill, *i.e.*, 1(a)(33), to designate only 35 U.S.C. §§ 89 and 90 of the RAA, clearly indicates that the entire RAA was not under consideration.

Pub. L. 313, H.J. Res. 423, 82d Cong., 2d Sess., entitled the "Emergency Powers Interim Continuation Act" was approved on April 14, 1952. The law extended "* * * needed statutory provisions * * * until June 1, 1952" and provided in pertinent part:[8]

> *Resolved by the Senate and House of Representatives of the United States of America in Congress assembled*, That notwithstanding the termination hereafter of the war with Japan declared December 8, 1941 (55 Stat. 795), and of the national emergencies proclaimed by the President on September 8, 1939 (Proc. 2352, 54 Stat. 2643), and on May 27, 1941 (Proc. 2487, 55 Stat. 1647), and notwithstanding any proclamation of peace with respect to such war—
>
> (a) Except insofar as they otherwise have further effectiveness the following statutory provisions and the authorizations conferred and liabilities imposed thereby

[8] While defendant argues that the emphasized language is broad enough to include permanent sections of the statutory provisions, including the permanent sections of the RAA, defendant's argument is not persuasive since, even under a literal reading of the emphasized language, the permanent sections of the RAA did not recite any terminal dates, were not dependent on any provisions of law, nor were they limited by reference to war or national emergency.

> shall remain in full force and effect to and including June 1, 1952, *notwithstanding any other terminal date or provision of law with respect to such statutory provisions and notwithstanding any limitation, by reference to war or national emergency*, of the time during or for which authorizations or liabilities thereunder may be exercised or imposed; and acts or events of the kind giving rise to legal consequences under any of those provisions when performed or occurring during the existing state of war shall give rise to the same legal consequences when they are performed or occur during the period above provided for. [Emphasis added.]

The law, however, differed from both President Truman's draft bill and the still pending H.J. Res. 386 with regard to the sections of the RAA which were to be included. Whereas both President Truman's draft bill and H.J. Res. 386 only referred to 35 U.S.C. §§ 89 and 90, the sections of the RAA which by 35 U.S.C. § 95 were intended to remain in force only during the continuance of the present war and 6 months, Pub. L. 313 identified the entire RAA as one of the statutory provisions to be extended.

No explanation or reasons for the inclusion of all sections of the RAA appear in Pub. L. 313.

The effectiveness of the statutory provisions covered by Pub. L. 313 was continued from June 1, 1952, to June 15, 1952, as a result of S.J. Res. 156. That resolution explained that S.J. Res. 139 was still under consideration and that the temporary extension to June 1, 1952, provided by Pub. L. 313 had not provided adequate time for the Senate to complete its studies. It, therefore, recommended that the involved statutes be "* * * extended for a future period until June15, 1952," which recommendation became Pub. L. 368 on May 28, 1952.

On June 6, 1952, the Committee on the Judiciary, to which a new H.J. Res. 477 had been referred, reported, by way of H. Rep. No. 2041, favorably thereon without amendment and recommended its passage. However, the committee recommended that the statutory provisions affected be continued for the duration of the national emergency proclaimed on December 16, 1950, and 6 months thereafter, but not beyond June 30, 1953. The statement accompanying the report reflects that the committee was intent on continuing a number of statutory provisions which would have expired by their

own terms upon the termination of the existence of a state of war with Japan or the national emergencies proclaimed by the President in 1939 and 1941, or in some cases, within a fixed time therefrom. The report set out the committee's analysis of each of the statutory provisions recommended by President Truman on February 19, 1952, along with the committee's recommendations and reasons therefor. The following appears with regard to 35 U.S.C. §§ 89 and 90, item 1(a) (33) on President Truman's draft bill:[9]

> *Adjustment of Royalties for Use of Inventions in Aid of Prosecution of the War (35 U.S.C. 89, 90)*
>
> These sections provide authority for requiring the return to the Government of an amount representing the difference between royalty returns based upon prewar periods of normal production and those which would be appropriate to the expanded production caused by war. They are effective *during the continuance of the present war and for 6 months after the termination thereof* (35 U.S.C. 95).
>
> The committee recommends that this item be continued, with language clarifying its application to a period in which there is no formally declared state of war.
>
> The committee is mindful that such intervention on the part of the Government is an invasion of the right of contract between the licensor and the licensee; a contract to which the Government was not a party. Nevertheless the committee is of the opinion that when a period of war or national emergency exists an individual is not entitled to excessive profits but rather owes a duty to the country to accept what is reasonable compensation under the circumstances. There is now pending before the Judiciary Committee permanent legislation on this subject.

It thus appears that the House Judiciary Committee, as late as June 6, 1952, only intended to include the war-dependent sections of the RAA among the statutory provisions covered by the Emergency Powers Continuation Act.

As of June 11, 1952, the Judiciary Committee for the Senate, to which S.J. Res. 139 had been referred, was still unable to make its recommendations. The committee, accord-

[9] H. Rep. 2041, 82d Cong., 2d Sess. 25 (1952).

ingly, recommended the adoption of H.J. Res. 164 to further extend the life of the 60 emergency statutes to June 30, 1952. On June 14, 1952, Pub. L. 393 accomplishing that purpose was approved.

S. Rep. No. 1744, on June 12, 1952, reported the Senate Judiciary Committee's recommendation on S.J. Res. 139. The report states:

> The Committee on the Judiciary, to which was referred the communication of February 19, 1952, from the President of the United States requesting legislation to continue in effect certain statutory provisions having considered the same, reports an original joint resolution and recommends that such resolution be adopted.

The report recognized the purpose of S.J. Res. 139 was—

> * * * to provide further *extension of certain emergency powers* heretofore enacted by the Congress for a period encompassing the duration of the emergency (plus 6 months) declared by the President on December 16, 1950 * * *. [Emphasis added.]

The statement accompanying the report echoes the same sentiments which were found in the statement accompanying H. Rep. 2041 and indicates a strong intent on the part of the Senate committee to continue the statutory provisions "* * * whose effectiveness depended upon the existence of a state of war or the emergencies referred to above" (the national emergencies previously proclaimed on September 8, 1939, and May 27, 1941). The report cataloged each of the statutory provisions included in President Truman's February 19, 1952, draft bill under 1 of 9 categories. The language used to include the RAA under the "*Construction, procurement and sale*" category, *i.e.*, "Adjustment of royalties for use of inventions in aid of prosecution of the war. 1(a)(33)" is strong evidence that the committee limited its consideration to 35 U.S.C. §§ 89 and 90 of the act. This is confirmed by the abstract of the testimony which appears at pp. 31 and 32 of S. Rep. No. 1744.

Public Law 450 did not Expressly Repeal 35 U.S.C. §§ 91–96

It would, of course, be helpful to know the exact reason why Pub. L. Nos. 313, 368, 393 and 450 referred to 35 U.S.C.

§ 89 and note and §§ 90–96, whereas H.J. Res. 386 and presumably S.J. Res. 139, which were still under consideration at the time that Pub. L. Nos. 313 and 368 were passed only included 35 U.S.C. §§ 89 and 90 among the 60 temporary statutory provisions to be extended. Unfortunately, the exact reason appears lost in the passage of time.

The above exhaustive review of available House and Senate documents related to Pub. L. 450 nonetheless makes abundantly clear that the intent of both the House and Senate was to continue the effectiveness of some 60 temporary statutory provisions identified therein to April 1, 1953. These documents are totally devoid of any indication that either the House or Senate intended to use Pub. L. 450 as a vehicle to repeal permanent legislation generally and §§ 91–96 of Title 35 in particular. Rather, the obvious intent of both the House and Senate was to continue for a temporary period wartime measures which would have expired as a result of the signing of the Japanese Peace Treaty.

A logical explanation for the inclusion of all sections of the RAA in Pub. L. 450 is suggested from the fact that the temporary sections, 35 U.S.C. §§ 89 and 90, are referred to in the other sections of the RAA. Moreover, § 95 contains the language:

> Sections 89 and 90 of this title shall remain in force only during the continuance of the present war [World War II] and for 6 months after the termination thereof * * *.

Accordingly, Congress could have referred to all sections of the act in Pub. L. 450 to emphasize and make clear that the temporary aspects of the act, regardless of where they were referred to, would be continued only to April 1, 1953, and no longer.

35 U.S.C. §§ 91–96 was not Repealed by Implication

As shown above, it is impossible to conclude that Congress sought to expressly repeal the permanent sections of the RAA. It is also concluded that Congress did not intend a repeal by implication of those sections.

Defendant argues that the passage by Congress of 10 U.S.C. § 2386, which authorizes military departments of the

Department of Defense to use funds to acquire, *inter alia*, licenses under patents and, as well, settle past claims of patent infringement, obviated the need for a permanent Royalty Adjustment Act. In defendant's own words:[10]

> * * * the conclusion is inescapable that Congress, having decided not to extend or make permanent the Royalty Adjustment Act and having granted the military departments statutory authority to buy rights in patents, copyrights and technical data (10 U.S.C. § 2386), had done all that the executive agencies really required and passed no further legislation in this area.

Defendant's arguments are unpersuasive and fail to acknowledge the long-established rule of statutory construction that frowns upon repeals by implication. This long-established rule is explained by the Supreme Court in the case of *United States* v. *Borden Co.*, 308 U.S. 188, 198 (1939), where that Court stated:

> * * * It is a cardinal principle of construction that repeals by implication are not favored. When there are two acts upon the same subject, the rule is to give effect to both if possible. [Citations omitted.] The intention of the legislature to repeal "must be clear and manifest. *Red Rock* v. *Henry*, 106 U.S. 596, 601, 602."

That course of action has been consistently followed by this court.[11] Indeed, in the case of *Casman* v. *United States*, 143 Ct. Cl. 16, 20, 181 F. Supp. 404, 406 (1958), where a similar argument was urged, this court stated:

> * * * the Government argues that the Veterans' Preference Act, supra, does not apply to the Foreign Service, that the Foreign Service Act, 60 Stat. 999, 22 U.S.C.A. § 801, superseded the Veterans' Preference Act and repealed by implication the transfer provisions of section 12. Admittedly, there is no express repeal provision in the Foreign Service Act.
>
> It is a familiar rule that repeal by implication is found only by reason of necessity, and repeals by implication are consistently frowned upon. Moreover, the intention of the legislature to repeal "must be clear and manifest." * * * It is further the rule that except in cases of clear repugnancy between an earlier and a latter

[10] Page 21 of defendant's July 19, 1974, brief in opposition.

[11] *See Ross* v. *United States*, 110 Ct. Cl. 190, 75 F. Supp. 725, *cert. denied*, 334 U.S. 832 (1948); *Badders* v. *United States*, 97 Ct. Cl. 506 (1942).

statute, the latter statute will not be deemed to have repealed the earlier, but effect to both should be given if possible.

Omission of 35 U.S.C. §§ 91–96 from the Code is of no Legal Significance

The failure of codifiers to include 35 U.S.C. §§ 91–96 in the 1952, 1958, 1964 and 1970 editions of the United States Code is of no legal significance. These particular statutes have since the passage of the Emergency Powers Continuation Act, Pub. L. 450 of the 82d Congress and Pub. L. 12 of the 83d Congress, received curious treatment. For example, the 1952 edition of the Code which became effective on January 2, 1953, indicates in the distribution table [12] for the new Title 35, which was intended to "show[ing] distribution of all sections of former Title 35," that former sections 89–96 of Title 35 "had expired." Yet, Pub. L. 12 of the 82d Congress had extended a number of the statutory provisions mentioned in Pub. L. 450, including the RAA, to July 1, 1953. While various explanations may be advanced for this treatment, it does highlight the fact that errors occur even in the United States Code. That the codifiers themselves would readily admit to this is evidenced from the following quotation from the preface to the 1970 edition.

> The Committee on the Judiciary invites criticisms or suggestions with the view of improving the Code wherever possible. It is hoped that the program of enacting the entire Code, title by title, to improve its present status as merely prima facie evidence of the law, will meet with early success.

From the language which follows, it is clear that the Fifth Circuit Court of Appeals [13] in the case of *Murrell* v. *Western Union Telegraph Co.*, 160 F. 2d 787, 788 (5th Cir. 1947), has reached the same conclusion:

> The United States Code was not enacted as a statute, nor can it be construed as such. It is only a *prima facie* statement of the statute law. The statutes collected in it did not change their meaning nor acquire any new force

[12] Vol. 8, U.S. Code, p. 8809, "Title 35—Patents."
[13] *See also Ashley* v. *City of Anchorage*, 95 F. Supp. 189 (D.C. Alaska 1951), *aff'd*, 196 F. 2d 809.

by their inclusion. If construction is necessary, recourse must be had to the original statutes themselves.

Decisions by this court also recognize that errors can occur in the United States Code and that the Code is merely *prima facie evidence of the law.* Indeed, the following language in the case of *American Export Lines, Inc.* v. *United States*, 153 Ct. Cl. 201, 207, 290 F. 2d 925, 928–29 (1961), indicates that this court recognizes that the statutes at large prevail over the Code when the two are inconsistent:

> It will be noted that 50 App. U.S.C. § 1738(b) (1952 and 1958 Eds.) omits the following language which appears in the original statute:
>
> * * * but, except upon the affirmative vote of not less than four members of the Commission, such rate shall not be less than 15 per centum per annum of the statutory sales price (computed as of the date of charter). * * *
>
> * * * apparently the codifiers thought that the sentence was no longer in force and effect.
>
> We think this was erroneous. The omitted sentence declares the policy of Congress relative to the amount of basic charter hire to be charged, except in exceptional circumstances. It was the clear purpose of Congress that the basic charter hire should not be fixed at less than 15 percent, unless it was clearly in the public interest that it be fixed at a lesser percentage. The codification should have retained an appropriate expression of this congressional purpose.
>
> It is well settled that "the Code cannot prevail over the Statutes at Large when the two are inconsistent." *Stephan* v. *United States*, 319 U.S. 423; *Royer's Inc.* v. *United States*, 265 F. 2d 615. The provisions of the Code are merely *prima facie* evidence of the law. 1 U.S.C. § 204(a).

Equally unpersuasive are the arguments:

> (1) that the failure by any agency to use the settlement clause of the RAA is evidence of its repeal; and
>
> (2) that the Commission on Government Procurement [14] would not have recommended in 1972 that all agencies be authorized to settle patent infringement claims with available appropriated funds if that authority existed in 35 U.S.C. § 91.

[14] Vol. 4, p. 124, of the 1972 report by the Commission on Government Procurement.

Syllabus

A possible explanation for the action by the Commission on Government Procurement may be that it was totally unaware of 35 U.S.C. § 91. Another possible explanation could be that it was aware of that statute but accepted the United States Code's recitation that it "had expired" at face value without making its own investigation. In any event, the failure of the Commission on Government Procurement to recognize the existence of 35 U.S.C. § 91 is of no moment and cannot be accepted as evidence of its expiration.

The short answer to the argument concerning nonuse of 35 U.S.C. § 91 speaking to its expiration is found in the case of *Jones* v. *Alfred H. Mayer Co.*, 392 U.S. 409, 437 (1968), where, when faced with a similar contention regarding a post-Civil War statute the Supreme Court quoted the following language from the oral argument of the Attorney General of the United States with approval: "The fact that the statute lay partially dormant for many years cannot be held to diminish its force today."

Thus, it is concluded that 35 U.S.C. §§ 91–96 was passed as permanent legislation, that it has not been expressly or implicitly repealed, and that it remains in full force and effect to this day.

Because this opinion involves an issue of controlling importance to the outcome of this litigation, within the meaning of Rule 53(c)(2)(i), any party dissatisfied with the order may, in accordance with Rule 53(c)(3), request a review.

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537 F. 2d 446

RICHARD S. MILLER & SONS, INC., RICHARD S. MILLER AND EDITH V. MILLER, DOUGLASS W. MILLER AND JOYCE M. MILLER, AND DANIEL MILLER AND JANIS R. MILLER v. THE UNITED STATES

[No. 653–71. Decided June 16, 1976]

ON THE PROOFS

Taxes; income tax; deductions; depreciation; insurance expirations; goodwill; useful life; value.—Plaintiffs seek refund of income taxes paid for taxable years 1966–1969, plus interest, claiming a depreciation allowance under Sec. 167(a) of the Internal Revenue Code of

Syllabus

1954 measured by a claimed 5-year useful life for the value of an intangible asset consisting of insurance expirations and current records and reports relating to fire and casualty insurance acquired by purchase of an insurance company (Arch), together with the goodwill. In addition to the expirations, plaintiff acquired from Arch intangible factors for access to former Arch clients that warranted protection through a covenant not to compete over the 60-month life of the contract that was separately bargained for and compensated. The value of these separate goodwill factors was a substantial part of the entire transaction. Both agencies were small enterprises located in a small rural community and engaged in other activities such as real estate sales, income tax preparation, etc. It is *held* that the 1,383 insurance expirations are separate and distinct from the goodwill transferred in the sale. It is also *held* that the package of expirations demonstrably was a wasting asset, and that on the basis of plaintiff's renewal experience with the information contained in the expirations, together with plaintiff's experience subsequent to 1969 on all policies, the useful life of the expirations can be estimated with reasonable accuracy to be not more than 10 years from the date of purchase of May 1, 1966. It is also *held* that the total cost plaintiff would have incurred to develop by internal growth the 1,383 policies would have been $47,644.35 and is the value of the insurance expirations. Plaintiffs have overpaid their Federal income taxes for 1966–1969 and are entitled to refunds, plus interest, as allowed by law. The case is remanded to the Trial Division for further proceedings pursuant to Rule 131(c).

Taxes; income tax; deductions; depreciation; intangible assets.

[1] An intangible asset, such as insurance expirations, may be subject to a depreciation allowance under 26 C.F.R. § 1.167(a)–3 if it is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy. Whether a particular intangible capital asset may be depreciated, when it is acquired by purchase of an ongoing operation, depends upon its identification with goodwill.

Internal Revenue ⟸ 719

Taxes; income tax; deductions; depreciation; intangible assets; goodwill.

[2] Goodwill is a concept that embraces many intangible elements of a business and is presumed to have a useful life of indefinite duration. Goodwill means expectancy that old customers will resort to the old place and is the sum total of all the imponderable qualities that attract customers and bring patronage to the business without contractual compulsion. In this court, for tax purposes, the intangible value of a business is divisible into its identifiable constituent elements.

Internal Revenue ⟸ 723

Syllabus

Taxes; income tax; deductions; depreciation; intangible assets; insurance expirations.

[3] In most sales of an ongoing business, insurance expirations are valuable only collectively and are considered to be a single intangible asset rather than a collection of individual policies. The "mass asset" rule does not prevent a depreciation deduction in a case where the expirations as a single asset can be valued separately and the requisite showing made that the useful life of the information contained in the intangible asset as a whole is of limited duration.

Internal Revenue ⇐ 719

Taxes; income tax; deductions; depreciation; intangible assets; goodwill.

[4] There is no *per se* rule of nondepreciability or nonamortizability in every case involving both goodwill and other intangible assets. The depreciability of assets such as customer and subscription lists, location contracts, insurance expirations, etc. is a factual question only.

Internal Revenue ⇐ 723

Taxes; income tax; deductions; depreciation; intangible assets; insurance expirations; taxpayer's burden of establishing right to deduction.

[5] A taxpayer has a heavy burden to establish a right to an allowance for depreciation for insurance expirations under Sec. 167(a) of the Code. The evidence must establish that the expirations (1) have an ascertainable value separate and distinct from goodwill and (2) have a limited useful life, the duration of which can be ascertained with reasonable accuracy. Precise exactitude is not required.

Internal Revenue ⇐ 719

Sales; covenant not to compete.

[6] A covenant not to compete, in a business where personal skill and individual reputation are major factors in the client relationship, is the primary protection for the buyer to assure that the ongoing business in fact is acquired.

Contracts ⇐ 116(1)

Taxes; income tax; deductions; depreciation; intangible assets; goodwill; value.

[7] The acquisition of a going concern provides to the buyer several advantages which are essential elements of goodwill and which are separable from insurance expirations and related records, such as the right of a purchaser to represent itself in the community as the successor of the seller's business, the seller's notification of its clients of the sale and its urging that they continue doing business with the purchaser.

Internal Revenue ⇐ 723

Per Curiam

Taxes; income tax; deductions; depreciation; intangible assets; useful life.

[8] In the realities of modern business technology, insurance expirations represent an intangible asset with an existence separate from other elements of goodwill. Useful life for depreciation purposes is an estimate, and the length of the useful period must be shown by evidence that allows it to be established with reasonable accuracy. The appropriate test is whether the particular taxpayer adequately has demonstrated that, in its business, the useful life of the challenged intangible reasonably may be approximated.

Internal Revenue ⇐ 719

Taxes; income tax; deductions; depreciation; intangible assets; insurance expirations; value.

[9] Where it has been established that the insurance expirations are separate and distinct from the goodwill transferred in the subject sale, the value of the expirations is measured by the cost the purchaser would have incurred to develop an equivalent quantity of new business, taking into consideration the number of new policies written, the total expenses incurred by insurance operations and the proportion of total insurance operating expenses used to develop new business.

Internal Revenue ⇐ 719

John A. Burgess, attorney of record, for plaintiffs. *John L. Carey* and *Thornburg, McGill, Deahl, Harman, Carey & Murray*, of counsel.

Allan C. Lewis, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

Before NICHOLS, KUNZIG, and BENNETT, *Judges*.

PER CURIAM: This case comes before the court on defendant's exceptions to the recommended decision of Trial Judge Kenneth R. Harkins, filed October 22, 1975, pursuant to Rule 134(h), having been submitted on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended decision, as hereinafter set forth, it hereby affirms and adopts the same as the basis for its judgment in this case. It is, therefore, concluded that plaintiffs are entitled to an allowance for depreciation of the intangible asset represented by the insurance expirations purchased from the Arch Insurance Agency in 1966, and that this intangible asset has a useful life of not more

than 10 years and a value of $47,644.35. Plaintiffs have overpaid their Federal income taxes for the years 1966, 1967, 1968, and 1969 and are entitled to refunds of this overpayment, plus interest, as allowed by law. This case is remanded to the Trial Division for further proceedings pursuant to Rule 131(c).

OPINION OF TRIAL JUDGE

HARKINS, *Trial Judge:* In this tax case, plaintiff taxpayers, shareholders of Richard S. Miller & Sons, Inc. (Miller & Sons),[1] seek refunds amounting to $8,782.75 from Federal income taxes paid in the 4-year period 1966–69. Returns for the years 1966 through 1969 were timely filed. Claims for refunds sought a depreciation allowance under the Internal Revenue Code,[2] measured by a claimed 5-year useful life, for the value of an intangible asset that consisted of insurance expirations and related papers acquired by purchase. Plaintiffs' refund claims were denied. This action has been properly and timely commenced, and the court has jurisdiction of the subject matter and of the parties. Trial was held at South Bend, Indiana, on May 28–29, 1974.

Effective May 1, 1966, Miller & Sons purchased the insurance business and agency, together with the goodwill and all current insurance records and papers, from the Arch Insurance Agency.[3] The records involved were concerned only with fire and casualty insurance. Both agencies were small enterprises that also engaged in related activities such as real estate sales, income tax preparation, and licensing and collection services. Both were located in Bremen, Indiana, a rural community with a population in 1966 of approximately 2,700 persons and a trading population in a 15-mile radius of approximately 6,000.

The sales contract transferred to Miller & Sons the Arch business and agency, its goodwill, its insurance records and

[1] Plaintiffs include the corporation, each of its shareholders, and two nonshareholding spouses who filed joint returns with their husbands. Miller & Sons is an electing small business association under sections 1371–79 of the Internal Revenue Code of 1954, as amended. Miller & Sons has paid no Federal income taxes and only the natural plaintiffs seek relief.

[2] 26 U.S.C. § 167(a) (1970).

[3] At the time of the sale, the Arch Insurance Agency was owned and operated by Mrs. Loren Teghtmeyer, the widow of Dewey Arch, who had founded the agency in the early 1930's and who had operated it until his death in 1955.

papers, which consisted primarily of 1,383 expirations or dailies, and the right to use the Arch name. Over the 60-month life of the contract, Miller & Sons paid $15,000 for a covenant not to compete, $4,694.51 for interest, and $61,174.92 for the balance of the assets. An expiration (or daily) is a copy of the face of an insurance policy made when the policy is issued. It shows the name of the insured, address, type of insurance, premium, carrier, property covered, and expiration date. Its principal value in the insurance business is its indication of the most advantageous time to solicit a renewal.

At issue is whether plaintiffs' evidence is sufficient to show that the indivisible asset represented by the 1,383 insurance expirations, as a factual matter, is separate from other elements of goodwill that concurrently were acquired by Miller & Sons as part of a going concern. For the reasons set forth below, plaintiffs have carried their burden and are entitled to depreciation deductions for this intangible asset. The 1,383 insurance expirations constitute a wasting mass asset that has a limited useful life, the duration of which can be ascertained with reasonable accuracy, and has a determinable value separate and distinct from goodwill.

I.

Section 167(a) of the Internal Revenue Code authorizes as a depreciation deduction a reasonable allowance for the exhaustion and wear and tear of property used in a trade or business. An intangible asset, such as insurance expirations, may be subject to a depreciation allowance, under the Treasury regulations, if it is "known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy."[4]

Whether a particular intangible capital asset may be depreciated, when it is acquired by purchase of an ongoing operation, depends upon its identification with goodwill. Where the useful life of an intangible readily can be shown to be limited, such as with a patent or a copyright, deprecia-

[4] 26 C.F.R. § 1.167(a)-3. The allowance is sometimes referred to as an "amortization" allowance when intangibles are involved. For uniformity, "depreciation" is used herein.

tion is available without question [5] even though for some purposes it is an element of goodwill.

Goodwill is a concept that embraces many intangible elements and is presumed to have a useful life of indefinite duration. Collectively, these intangibles are associated with continuing favorable customer patronage and goodwill is seen as a self-regenerating asset whose economic value fluctuates but does not necessarily diminish. Since by definition goodwill has no ascertainable useful life, the presumption that this intangible is a nondepreciable capital asset is conclusive.[6] The Treasury regulation specifically provides "[n]o deduction for depreciation is allowable with respect to goodwill." [7]

The term "goodwill" has a varying content, depending on its usage. Goodwill sometimes is used to describe the aggregate of all of the intangibles of a business, including such items as patents, trademarks, leases, contracts, and franchises. Since a normal rate of return usually is calculated on tangible assets only, goodwill has been used as a synonym for the return on all the intangibles of a business.[8] In a more restricted sense, goodwill is the expectancy that the old customers will resort to the old place.[9] It is the sum total of all the imponderable qualities that attract customers and bring patronage to the business without contractual compulsion.[10] Another definition equates goodwill with a rate of return on investment which is above normal returns in the industry and limits it to the residual intangible asset that generates earnings in excess of a normal return on all other tangible and intangible assets.[11] In this court, for tax purposes, the in-

[5] *Ibid.*

[6] *Miami Valley Broadcasting Corp.* v. *United States*, 204 Ct. Cl. 582, 591, 499 F. 2d 677, 681 (1974); *Houston Chronicle Publishing Co.* v. *United States*, 481 F. 2d 1240, 1247 (5th Cir. 1973).

[7] 26 C.F.R. § 1.167(a)–3.

[8] *Meredith Broadcasting Co.* v. *United States*, 186 Ct. Cl. 1, 19, and cases there cited, 405 F. 2d 1214, 1224 (1968).

[9] *Winn-Dixie Montgomery, Inc.* v. *United States*, 444 F. 2d 677, 681 (5th Cir. 1971).

[10] *Houston Chronicle Publishing Co.* v. *United States*, *supra* note 6, 481 F. 2d at 1248 n. 5.

[11] Note, *Amortization of Intangibles: An Examination of the Tax Treatment of Purchased Goodwill*, 81 HARV. L. REV. 859, 861 (1967–68).

tangible value of a business is divisible into its identifiable constituent elements.[12]

Both the Internal Revenue Service and many courts in cases that have considered depreciation allowances for insurance expirations have tended to identify such intangibles with goodwill, either by viewing the expiration list as goodwill itself or by finding it so related to goodwill that it was inextricable therefrom. Revenue rulings in 1965 equated the price of insurance expirations with the price paid for goodwill and indicated as a matter of law that such could not be recovered by a purchaser through depreciation or amortization. Insurance expirations were treated as intangibles in the nature of goodwill that provided a customer structure that lasts an indefinite time in the future.[13]

The Tax Court, in a case that involved the transfer of an ongoing insurance agency and its goodwill, stated that any definition of goodwill would include "the concept of the advantage that the proprietor of an existing business enjoys resulting from the probabilities that old customers will continue their patronage" and that it is "difficult to see how any insurance agency could transfer its goodwill without delivering its insurance expiration list to the transferee." The list of expirations was considered an integral part of the goodwill of a going insurance agency business.[14]

In most sales, the insurance expirations are valuable only collectively and they are considered to be a single intangible asset rather than a collection of individual policies. Under the "mass asset" rule, the value of the whole does not diminish by the loss of a component, a loss deduction is not appropriate for the loss of a component, and the single entity, unlike the components, has been considered in many cases to have no determinate useful life.[15] The rationale and purpose of the mass asset rule "is to prevent taxpayers from increasing the value of depreciable property to offset the amount paid in

[12] *KFOX, Inc.* v. *United States*, 206 Ct. Cl. 143, 164–65, 510 F. 2d 1365, 1376 (1975); *Meredith Broadcasting Co.* v. *United States*, *supra* note 8, 186 Ct. Cl. at 18, 405 F. 2d at 1224.

[13] Rev. Rul. 65–175 and 65–180, 65–2 CUM. BULL. 41 and 279.

[14] *Thoms* v. *Commissioner*, 50 T.C. 247, 256 (1968); *see also Tomlinson* v. *Commissioner*, 58 T.C. 570, 581–82 (1972), *aff'd*, 507 F. 2d 723 (1974).

[15] *Winn-Dixie Montgomery, Inc.* v. *United States*, *supra* note 9, 444 F. 2d at 686; *Golden State Towel & Linen Serv.* v. *United States*, 179 Ct. Cl. 300, 305, 373 F. 2d 938, 941 (1967).

excess of book value of assets purchased. This doctrine makes it possible to strike down depreciation deductions for amounts which should properly be allocated to good will." [16] As applied in cases dealing with depreciation for insurance expirations, the mass asset rule did not allow the acquisition cost to be depreciated because the expirations were so "inextricably" linked with goodwill that they could not be considered as having a separate existence.[17] As noted by the dissent in *Marsh & McLennan*, however, the mass asset rule does not prevent a depreciation deduction in a case where the expirations as a single asset can be valued separately and the requisite showing made that the useful life of the information contained in the intangible asset as a whole is of limited duration.[18]

Identification of insurance expirations with goodwill, as a matter of law, either through equating with goodwill or through application of the "mass asset" concept, has been clarified. Entitlement to a depreciation allowance is a question of fact and not of law.[19]

There is no per se rule of nondepreciability or nonamortizability in every case that involves both goodwill and other intangible assets. The depreciability of assets such as customer and subscription lists, location contracts, insurance expirations, etc., is a factual question only.[20] The taxpayer has a heavy burden to establish a right to an allowance for depreciation for insurance expirations. The evidence must establish that the expirations (1) have an ascertainable value separate and distinct from goodwill and (2) have a limited useful life, the duration of which can be ascertained with reasonable accuracy. In application of this test, precise exactitude is not required. As the court in *Houston Chronicle* states:

> Our view—that amortizability for tax purposes must turn on factual bases—is more in accord with the realities of modern business technology in a day when

[16] *Commissioner* v. *Seaboard Finance Co.*, 367 F. 2d 646, 652 (9th Cir. 1966).
[17] *Marsh & McLennan, Inc.* v. *Commissioner*, 420 F. 2d 667, 668 (3d Cir. 1969).
[18] *Id.* at 672–73 n. 3.
[19] *Houston Chronicle Publishing Co.* v. *United States*, *supra* note 6, 481 F. 2d at 1249.
[20] Rev. Rul. 74–456, 74–2 CUM. BULL. 65.

lists are bartered and sold as discrete vendible assets. Extreme exactitude in ascertaining the duration of an asset is a paradigm that the law does not demand. All that the law and regulations require is reasonable accuracy in forecasting the asset's useful life. [481 F. 2d at 1253–54.]

II.

The taxpayer bears all burdens in regard to establishing a right to claim a depreciation allowance for insurance expirations under section 167(a).[21] In this case, this burden is particularly difficult because Arch goodwill in fact was transferred at the same time as the expirations. Cases that have recognized a depreciation deduction for insurance expirations generally have found no goodwill to be present in the sale, *i.e.*, where the seller had "run-down" the agency, ruined its reputation, and no goodwill was left;[22] where the seller had gone out of the fire and casualty business but remained in other insurance business and did not sell goodwill;[23] or where the seller's insurance business was primarily walk-in trade acquired as an incidental sideline to other activities.[24]

Goodwill

At the threshold, plaintiffs must show that the 1,383 Arch insurance expirations are separate and distinct from the goodwill that was transferred in the sale. The most significant indication that an intangible asset is separate and distinct from goodwill is whether its useful life can be shown with reasonable accuracy to be of limited duration. The most important criterion is whether in fact it is a wasting asset.[25]

Plaintiffs contend, because the Arch Insurance Agency was a dying organization, goodwill in the sale was of minimal value or was nonexistent. It is clear that this was the sale of a going concern that had demonstrated a pattern of growth. In addition to the expirations, Miller & Sons acquired from

[21] *KFOX, Inc.* v. *United States, supra* note 12, 206 Ct. Cl. at 151–52, 510 F. 2d at 1369; *Houston Chronicle Publishing Co.* v. *United States, supra* note 6, 481 F. 2d at 1245.

[22] *Savings Assurance Agency, Inc.*, 22 T.C. Mem. 200 (1963).

[23] *Weaver* v. *United States*, 65–1 USTC § 9410 (W.D. Okla.).

[24] *Vaaler Ins., Inc.* v. *United States*, 68–1 USTC ¶ 9133 (N. Dak.). *But see Stewart* v. *United States*, 65–2 USTC § 9607 (N.D. Okla.).

[25] Detailed findings of fact on which the award to plaintiffs is based are filed herewith. Facts necessary for perspective and which control the decision are set forth in this opinion.

Arch intangible factors for access to former Arch clients that warranted protection through a covenant not to compete that was separately bargained for and compensated. The value of these separate goodwill factors was a substantial part of the entire transaction.

The extent and nature of the goodwill transferred are delineated by the business context of the transaction. Both Miller & Sons and Arch, with annual gross commissions in the $28,000 to $34,000 range, were small business enterprises in Bremen, Indiana. Each, in addition to the fire and casualty insurance agency business, provided additional related services. These additional services included real estate sales, income tax preparation, running a license bureau, and a gas collection service. Bremen, Indiana, is a rural community with a population of 2,700 persons at the time of the sale and a trading population, within a 15-mile radius accessible to both agencies, of approximately 6,000 persons. Richard Miller, the founder and principal solicitor of Miller & Sons, knew by sight approximately 85 percent of the population of Bremen, and the principal method of selling insurance in the marketing area was through face-to-face contacts.

The Arch Insurance Agency had been active in Bremen since the early 1930's and had competed with Miller & Sons after that agency was founded in 1961. At the time of the sale, Bremen, Indiana, and the surrounding marketing area were served, in addition to Arch and Miller & Sons, by a State Farm Insurance Company agent and a part-time Allstate Insurance Company agent. Shortly after the sale, another independent agent became operative in the marketing area.

Fire and casualty insurance is more competitive than other types of insurance, and is characterized by the tendency of policyholders to change insurance companies more frequently than is the experience in life, health and accident, or medical insurance. For this reason, expirations in the fire and casualty insurance business, with their information on the most propitious time to solicit renewals, are particularly valuable assets that are bought and sold.

In the sale to Miller & Sons, goodwill specifically was transferred by the contract. Intangible assets acquired

through the contract, in addition to goodwill, were a covenant not to compete for 5 years, the right to use the Arch name, and the information on the insurance expirations and related records.

The most significant indication that goodwill was transferred in the sale was the fact, with full knowledge of competition in the marketing area, Miller & Sons agreed to pay $15,000 to assure that neither Mrs. Teghtmeyer nor Charles Arch would do business in fire and casualty insurance in the marketing area for a 5-year period. A covenant not to compete, in a business where personal skill and individual reputation are major factors in the client relationship, is the primary protection for the buyer to assure that the ongoing business in fact is acquired.

Payments under the contract were to be 22.5 percent of the buyer's gross commissions for 60 months, with allocations earmarked for interest and for the covenant not to compete. This method of payment is typical of the sale of an ongoing business and accompanying goodwill.

A general insurance agency is a personal service business and the attachment of a client to a particular agent is important. Superiority of service from personal skill and efforts provides a competitive advantage which is difficult to transfer in a sale. Notwithstanding the fact that the goodwill of a personal service business, in large part, is dependent upon the individual relationships and qualifications of the seller, the acquisition of a going concern does provide to the buyer several advantages which are essential elements of goodwill and which are separable from the expirations and related records. Through the purchase, Miller & Sons acquired the right to represent itself in the community as the successor to the Arch Insurance Agency's business. Both Miller & Sons and Mrs. Teghtmeyer notified former Arch clients of the sale and encouraged continued business with Miller & Sons. Although Miller & Sons did not need such introduction to identify the Arch clientele, or to gain an entree into the marketing area, these communications were valuable and were sought by Miller & Sons to encourage renewals from former Arch clients.

Although goodwill was a substantial element in the sale, the transfer of an ongoing business was not the primary objective sought by Miller & Sons. The transfer of goodwill, during the negotiations, was not bargained for specifically. After the sale, Miller & Sons did not use the Arch name, its location, its sales personnel, or office procedures. The sales contract did not include office equipment, furniture, motor vehicles, or chattel personal property, nor did it include intangibles such as cash, notes, accounts receivable, or uncollected premiums. The use of the seller's name in the single letter that each party sent to Arch clients, in the circumstances, is not sufficient to show that a major consideration was an attempt to trade on the name of Arch.

Limited Useful Life

In the Bremen marketing area, Miller & Sons did not need to purchase the Arch expirations in order to gain an entree into the market, nor did it need the expirations to identify Arch clients. Acquisition of the body of information that was contained in the expirations permitted Miller & Sons to incorporate in its files information that otherwise could have been acquired by internal growth. The purchase of the expirations was a substitute for time and effort to develop and place on the books a comparable number of policies for the first time. In the realities of modern business technology, the expirations represented an intangible asset with an existence separate from other elements of goodwill.

An intangible asset is separate and distinct from goodwill when its useful life can be shown with reasonable accuracy to be of limited duration. The 1,383 insurance expirations and related records purchased by Miller & Sons constituted a single, indivisible asset. The useful life of this mass asset is determined from facts relative to the whole, and not from experience with any particular policy or account involved. Of the expirations purchased, 60 percent involved policies that expired 1 year from the date of sale and the remaining 40 percent expired 3 years from the date of sale. Accordingly, all of the information contained in the expirations would have been used for the first time by Miller & Sons, and either continued as renewals or abandoned because of nonrenewal, by the end of 3 years.

The information in the expirations was incorporated into Miller & Sons' recordkeeping routines. Three identical labels were made for each, with the name of the insured, address, type of insurance, premium, insurance carrier, billing date, and expiration date. One label identified the envelope, filed alphabetically, that contained the expiration. The second label was filed alphabetically in a 3-inch x 5-inch card index. The third label was filed alphabetically by month of expiration. Prior to each respective expiration date, this information was used to solicit a renewal. If the policy was not renewed, no further use was made of the expiration by Miller & Sons.

Miller & Sons' nonrenewal experience, in both accounts and policies, in the 1,383 expirations was at a higher rate in the years immediately following the sale than it was in later years. Of the 844 accounts in the expirations, 122 were not renewed in the remaining 8 months of the first year, 161 additional were not renewed in the second year, so that by the end of 1967, 283 accounts or 33.53 percent had been lost. By the end of the first 5 years, an additional 144 accounts were not renewed. At that time, 427 accounts or 50.59 percent had been lost, and less than one-half remained active.

In the 24 months following the sale, the average annual nonrenewal rate for policies was 19.7 percent, with 545 (39.41 percent) of the 1,383 policies not renewed. In the 5-year period measured by 60 months from May 1, 1966, the average nonrenewal rate was 11.2 percent. At the end of 5 years, from the 1,383 expirations, 773 policies were no longer being written by Miller & Sons and 427 of the 844 accounts no longer were using Miller & Sons for their insurance needs. The package of expirations demonstrably was a wasting asset.[26]

The Arch expirations purchased by Miller & Sons would have been exhausted in 5.08 years at the May 1966–April 1968 nonrenewal rate, and would have been exhausted in 8.92 years at the May 1966–April 1971 nonrenewal rate. By the end of April 1971, 60 months had elapsed from the date of sale. At that time, Miller & Sons' obligations to make further payments under the contract ceased, and the covenant not to

[26] *Holden Fuel Co. v. Commissioner*, 479 F. 2d 613, 615 (6th Cir. 1973).

compete expired. The term of the covenant measures the period that the parties believed the goodwill acquired from Arch needed to be protected. After the 5 years, the goodwill acquired by Miller & Sons from Arch no longer is identifiable in Miller & Sons' operations. Renewals thereafter are the product of the personal efforts, related services, and reputation of Miller & Sons. After the 5-year period, the information in the Arch expirations was amalgamated in Miller & Sons' records and procedures, and Miller & Sons' renewal experience would apply to the remaining policies and accounts acquired from Arch.

In the period January 1970 through April 1974, the average annual nonrenewal rate for all policies of Miller & Sons was 10 percent.

The Treasury regulations permit depreciation of an intangible asset when the knowledge of its limited useful life can be shown "from experience or other factors." [27] "Useful life" for depreciation purposes is an estimate, and the length of the useful period must be shown by evidence that allows it to "be estimated with reasonable accuracy." The law does not demand "[e]xtreme exactitude in ascertaining the duration of an asset." [28] The appropriate test is whether the particular taxpayer adequately has demonstrated that, in his business, the useful life of the challenged intangible reasonably may be approximated.[29]

That the useful life of the collective information contained in the 1,383 expirations has limits is not impaired by the fact that, after the end of the 5-year period, 417 former Arch accounts continued to do business with Miller & Sons, and 581 policies had been renewed. In *Marsh & McLennan*, the court found that as long as a customer renews "the customer relationship is still derivative of the initial situation" as successor to the seller.[30] In that case, however, the court disallowed depreciation for costs of acquiring the expiration lists because it found (1) the expirations were inextricably

[27] 26 C.F.R. § 1.167(a)–3.
[28] *Houston Chronicle Publishing Co.* v. *United States*, *supra* note 6, 481 F. 2d at 1253–54.
[29] *Burnet* v. *Niagara Falls Brewing Co.*, 282 U.S. 648, 654–55 (1931); *Super Food Services, Inc.* v. *United States*, 416 F. 2d 1236, 1240 (7th Cir. 1969).
[30] *Marsh & McLennan, Inc.* v. *Commissioner*, *supra* note 17, 420 F. 2d at 670.

linked with goodwill as a matter of law and on the facts before it and (2) that the statistical evidence, on which the estimate of the useful life of the accounts involved was based, was insufficient because it was based on the buyer's experience in a period prior to the sale and not based on the buyer's experience with the accounts sold. Here, the estimate of the length of the useful life of the Arch expirations is based upon Miller & Sons' experience with the former Arch clients during a 5-year period and thereafter based upon Miller & Sons' loss experience on all of its policies.

Defendant claims that plaintiff cannot establish that the Arch expirations had a limited useful life because Miller & Sons' records do not reflect referrals made by former Arch clients, both those who had renewed or had not renewed their policies. Defendant claims the record is clear that referrals by satisfied customers are a fruitful source of new customers and that referrals occur regularly and frequently.

The fact that Miller & Sons did not maintain records on referrals does not preclude the showing that the Arch expirations have a limited useful life. In the Bremen market, as in the case of renewals, referral business after the 5-year period would reflect the personal skill, integrity, and reputation of Miller & Sons, and would not derogate from limitations on the useful life of the Arch expirations. In this market, a referral from a former Arch client has no more significance than a referral from any other person in the area.

On the basis of Miller & Sons' renewal experience with the information contained in the 1,383 Arch expirations, together with Miller & Sons' 1970–74 experience on all policies, the useful life of the intangible asset represented by the Arch expirations can be estimated with reasonable accuracy to be not more than 10 years from the date of purchase on May 1, 1966.

Value

In addition to showing that the expirations had a limited useful life, plaintiffs also must show that this asset had an ascertainable value separate and distinct from goodwill. No allocation for goodwill was made in the negotiations to purchase the Arch Insurance Agency. An independent value was separately negotiated and established for the covenant not

to compete. At the time the sales agreement was executed, the parties had manifested in a timely fashion their intention to allocate a portion of the purchase price to the covenant not to compete.[31] Neither before, during, nor after the negotiations did Miller & Sons examine each individual name or policy among the acquired expirations, or separately appraise the value of each client or policy. No value was allocated by the parties to the expirations either as a single asset, or as a collection of independently valued parts. Exclusive of the amounts for the covenant not to compete and interest, the price paid by Miller & Sons was for two kinds of intangible assets: (1) goodwill or property in the nature of goodwill and (2) for the information in the 1,383 expirations and accompanying records.

By acquisition of the Arch expirations, Miller & Sons, at one stroke, nearly doubled its volume. The expirations represented policies in being and were a substitute for the generation of an equivalent amount of business by Miller & Sons through internal growth. Individually, an expiration represents the one-time cost and expense of adding a new client and putting a policy on the books for the first time. Initial solicitation costs are a recognized category of standard operating expense; one phase of the normal business of a general insurance agency consists of the development of new business. Costs associated with development of new business normally are higher than costs required to retain or renew policies already on the books.

The value of the Arch expirations is measured by the costs Miller & Sons would have incurred to develop an equivalent quantity of new business. This requires information on three factors: (1) the number of new policies written; (2) the total expenses incurred by insurance operations; and (3) the proportion of total insurance operating expenses that are used to develop new business.

With the acquisition of the Arch Insurance Agency in 1966, Miller & Sons' business, as measured by gross commissions, increased from $28,328 in 1965 to $63,399 in 1967, and remained relatively constant at this level until 1970, when new

[31] *General Ins. Agency, Inc.* v. *Commissioner*, 401 F. 2d 324 (4th Cir. 1968); *Robins & Weill, Inc.* v. *United States*, 382 F. Supp. 1207, 1216 (M.D. N. Car. 1974).

growth commenced. In the period between 1967 and 1970, Miller & Sons' operations, as reflected by gross commissions and by the testimony of plaintiffs' witnesses, were devoted to assimilation of the Arch business and reorganization and show no significant development of new business. Miller & Sons did not maintain records or information that establish the number of new policies written from 1966 through 1969.

Inasmuch as business in the period 1966–69 was relatively constant, and new growth did not start until after 1970, the period 1970–74 is more representative for purposes of computation of development costs. In the year 1970, Miller & Sons wrote 231 new policies, and 261, 282, and 325 new policies were written in 1971, 1972, and 1973, respectively. A total of 1,099 new policies were written in this period.

The total expense incurred by Miller & Sons in the period 1970–73 in its insurance business amounted to $228,102. Of this amount, the portion devoted to development of new business amounted to 16.6 percent, or a total of $37,865.[32] The weighted average cost to Miller & Sons to develop each new policy in the period 1970–73 was $34.45. It is appropriate to apply this unit cost to the number of policies in the 1,383 expirations acquired in 1966 because the period is representative of Miller & Sons' operations in a period characterized by internal growth rather than growth by acquisition. As so applied, the total cost Miller & Sons would have incurred to develop by internal growth the 1,383 policies acquired from the Arch Insurance Agency would have been $47,644.35 and is the value of this depreciable intangible asset.

FINDINGS OF FACT

I.

1. (a) Plaintiff Richard S. Miller & Sons, Inc. (Miller & Sons), is an Indiana corporation organized in 1961 with its principal place of business in Bremen, Indiana. The business had been operated since 1953 by Richard S. Miller as a sole

[32] Plaintiffs contend that 20 percent of Miller & Sons' time was devoted to development of new business in 1966–69 and that the total insurance expense should be allocated on that basis. In the period 1970–73, however, the only period with relevant new business statistics, only 16.6 percent of Miller & Sons' resources was spent to develop this business.

proprietorship. For Federal income tax purposes, its taxable year is October 1 through September 30. At all times relevant to this case, Miller & Sons was an electing small business corporation under sections 1371–79 of the Internal Revenue Code of 1954, as amended.

(b) Shareholders of Miller & Sons, with respective stock interests, have been as follows:

	No. of shares owned from date of incorporation to Sept. 15, 1971	No. of shares owned after Sept. 15, 1971 to present
Richard S. Miller	225	165
Edith V. Miller	225	225
Daniel L. Miller	136	196
Douglass W. Miller	196	196

(c) Individual plaintiffs are married couples, shareholders of Miller & Sons, who reside in Bremen, Indiana, as follows:

Richard S. Miller and Edith Miller
Douglass W. Miller and Joyce M. Miller*
Daniel L. Miller and Janis R. Miller*

*Not a shareholder; Federal income tax returns filed jointly with husband.

2. (a) The Commissioner of Internal Revenue assessed and collected from plaintiffs additional Federal income taxes for 1966 through 1969; plaintiffs' respective claims for refunds have been denied as follows:

	1966	1967	1968	1969	Total
Richard S. & Edith V. Miller	*$845.24	$1,649.94	$1,616.43	$2,106.93	$6,218.59
Douglass W. & Joyce M. Miller	*322.83	632.92	235.29	499.28	1,690.32
Daniel L. & Janis R. Miller	*187.44	273.75	131.09	281.56	873.84
Total	1,355.51	2,556.61	1,982.86	2,887.77	8,782.75

*Includes assessed interest.

(b) This action for refund of Federal income taxes has been properly and timely commenced. The court has jurisdiction of the subject matter and the parties.

II.

3. (a) Dewey Arch founded the Arch Insurance Agency in the early 1930's, and operated the agency until his death on June 26, 1955. Thereafter, his widow, who on November 26, 1961, was remarried to Loren Teghtmeyer, operated the Arch Insurance Agency. Additional services provided by the Arch Insurance Agency included a license bureau, a gas collection service, and real estate sales.

(b) Mrs. Teghtmeyer, a resident of Bremen, Indiana, until her death on October 26, 1968, was active in civic affairs and in local organizations, was well liked in Bremen, Indiana, and in the surrounding community, and had a good moral reputation. In 1966, Mrs. Teghtmeyer sought to sell to Miller & Sons the Arch Insurance Agency, including the agency's name, goodwill, building, office equipment, and insurance expirations and accompanying records.

III.

4. (a) Bremen, Indiana, is a rural community, located in north-central Indiana, with a population of 2,700 persons in the middle 1960's and a population at the time of trial of approximately 3,600 persons. The trading population within a 15-mile radius of Bremen, Indiana, was approximately 6,000. Prior to 1966, Bremen, Indiana, and the surrounding community was serviced by two independent insurance agencies (Arch Insurance Agency and Miller & Sons), a State Farm Insurance Company agent, and a part-time Allstate Insurance Company agent. Shortly after the sale, another independent agent began operations in the area.

(b) Since its creation in 1961, Miller & Sons has been engaged in the business of a fire and casualty insurance agency. Miller & Sons did not and does not sell life, health and accident, or medical insurance policies. Additional services provided by Miller & Sons include real estate sales and income tax preparation. During the years in issue, Richard S. Miller was the principal solicitor of Miller & Sons and knew, by face and name, approximately 85 percent of the population of Bremen, Indiana. The business of Miller & Sons is, and was, a personal service business and the use of tangible capital was not a material income-producing element. The principal method of selling in its marketing area, an area within a radius of 15 miles from Bremen, Indiana, was face-to-face contact.

(c) In April 1966 and during the years in issue in this case, 73 percent of the policies of Miller & Sons were attributable to homeowners, fire, and automobile insurance policies. These policies contributed approximately 66 percent of the total gross premiums of Miller & Sons. Sixty percent of Miller & Sons' policies were personal and the balance were

commercial; personal policies counted for 59 percent of the dollar volume. Sixty percent of Miller & Sons' policies were 1-year policies; 40 percent were 3-year policies. The existing policies of the Arch Insurance Agency in April 1966 were generally comparable.

(d) Miller & Sons never sold an insurance policy which expired more than 5 years from the date of sale; and, since approximately 1968, Miller & Sons has not sold an insurance policy which expired more than 3 years after date of sale. Miller & Sons never sold any insurance policy which contractually obligated the purchaser to maintain the policy in force until or after the expiration date. With the exception of direct bill or continuous policies (continued indefinitely upon payment of the premium), fire and casualty policies are written for periods of 3 years and 1 year. The trend at Miller & Sons is, and has been, for insurance policies to be written for shorter terms.

(e) Between 1961 and March 1966, Arch Insurance Agency had a pattern of growth. In 1966, the Arch Insurance Agency had 1,383 policies outstanding that involved 844 different accounts or insureds. The composition of Arch Insurance Agency policies as to type, term, and contribution to dollar volume was comparable to policies then being written by Miller & Sons. For each policy written, the insurance agency (Miller & Sons-Arch Insurance Agency) is entitled to receive approximately 20 percent of the annual premium paid by the insured. This amount is referred to as the agent's "gross commission." Current gross commissions, including contingent commissions, of Arch Insurance Agency at the time of the sale in 1966 were approximately $34,000.

(f) Gross premiums and gross commissions of Miller & Sons have been as follows:

Fiscal Year Ended September 30	Gross Premium	Gross Commission
1961	$70,444	$16,202*
1962	70,340	16,645
1963	102,399	21,025
1964	118,317	27,019
1965	121,562	28,328
1966	237,621	42,214
1967	370,710	63,399
1968	348,081	62,049
1969	319,654	62,074
1970	342,571	65,833
1971	375,575	75,187
1972	421,660	93,004
1973	455,597	95,811

*Estimate.

(g) An expiration (or daily) is a conformed or carbon copy of an insurance policy written when the insurance policy is issued. The information shown on an expiration consists of the name of the insured, the address, type of insurance, premium, insurance carrier, billing date, expiration date, and description of the property covered. An expiration is the property of the agent who writes the policy, is a valuable asset used in the business, and is necessary to the conduct of the business. The principal value of an expiration is the indication of the most advantageous time to solicit a renewal. Other values include competitive advantages derived from knowing the prior rates, amount of coverage, premiums, and conditions. Additionally, an expiration represents a policy in being and is a measure of the cost an insurance agency incurs in putting a policy on the books for the first time. Initial solicitation and acquisition costs are standard operating expenses which normally are higher than the cost of maintaining and renewing a policy once written. Insurance expirations are valuable business assets, which are bought and sold.

(h) Renewal is the act of the insured that continues a policy in force for an additional term after the lapse of the initial terms; a lost renewal results from the failure of the insured to renew a policy. Loss of renewals is a known and accepted economic fact in the general independent insurance agency business. The rate of loss of renewals varies among insurance agents. Loss of renewals occurs in the regular course of business from causes that include changes in the insured's needs such as moving, getting old, going out of business, excessive losses, and dissatisfaction or competition from other agents. The nonrenewal rate for the first year after purchase of expirations in northern Indiana in the normal course would be expected to be between 20 percent and 35 percent.

(i) In the insurance industry, there is a rule of thumb formula for computation of the price to be paid for an agency in a sale. The rule of thumb is to multiply the gross com-

missions for the prior year, or an average for several prior years, by a factor that varies between one and two, dependent on bargaining between the parties.

IV.

5. (a) On March 17, 1966, Bernice Teghtmeyer, doing business as Arch Insurance Agency, entered into a contract of sale with Miller & Sons, Inc., to be closed on or before April 30, 1966.

(b) Pursuant to the contract, Miller & Sons purchased from Arch Insurance Agency the insurance business and agency, together with the goodwill and all current insurance records and papers, but excluding all office equipment, furniture, motor vehicles, and chattel personal property used in connection with the operation of said business and insurance agency. The agreement did not include cash or notes or accounts receivable, or uncollected premiums on policies written before the closing date, or accounts payable, but did include the seller's business name. Miller & Sons never used the place of business, sales personnel, or the name of the Arch Insurance Agency.

(c) The agreement also included a covenant not to compete for a period ending 5 years from the closing date of the agreement. This covenant obligated Bernice Teghtmeyer and Charles Arch not to—

> directly or indirectly own, manage, operate, control, lend money to, endorse the obligations of, or participate or become connected as an officer, stockholder, employee, partner or otherwise with any business engaged to any extent in the insurance business in the Town of Bremen, Marshall County, Indiana, or in any geographical area within a radius of fifteen (15) miles of said Town, or within the confines of Marshall County, State of Indiana.

(d) The agreement provided that the seller would receive $15,000 by the closing date and 22.5 percent of the purchaser's total gross commissions, payable monthly over a 60-month period, but not less than $60,000. The monthly payment included one-third of 1 percent as payment on interest,

and $250 as payment on the covenant not to compete. Over the 60-month life of the contract, Miller & Sons paid to the Arch Insurance Agency the following amounts:

Covenant not to compete	$15,000.00
Interest	4,694.51
Principal (assets purchased)	61,174.92
Total	$80,869.43

(e) Miller & Sons and Bernice Arch Teghtmeyer did not negotiate with respect to allocating any amount to goodwill and no amount of the purchase price was allocated to goodwill. Before, during, and after the negotiations with Mrs. Teghtmeyer, Miller & Sons did not examine each individual name or policy on the Arch Insurance Agency's expirations or separately appraise the value of each individual name or policy. Miller & Sons did not, on or before May 1, 1966, make a statistical study, based on Arch Insurance Agency's prior experience, to determine the useful life of the purchased expirations.

(f) The agreement provided that the seller would continue to operate its business without any change in general policy or manner of conduct prior to the closing and, after the closing, the purchaser would use its best efforts to continue and to increase the business. Both parties were obligated to continue to operate their respective insurance businesses in the same manner as heretofore operated, to cooperate fully in effectuating a smooth transition of business operations as of the closing, and both parties agreed—

> to work together to make the necessary and appropriate press releases and other business changes in the interest of effecting the continuity of the Seller's business to the best interests of the Purchaser and the continued operations of the Purchaser contemplated subsequent to the closing of this Agreement and during the term of this Agreement.

(g) After the sale, Bernice Arch Teghtmeyer retired and did not render consulting services to Miller & Sons. Mrs. Teghtmeyer instructed her former employee to ask people to stay with Miller & Sons, if the Arch client inquired, and she

spoke with her customers, when they asked, and urged them to stay with Miller & Sons.

(h) On April 15, 1966, Miller & Sons sent a notice to Arch Insurance Agency clients that it would service their insurance needs in the future. The notice stated in part:

> We have been fortunate in obtaining the services of Mrs. Norma Robinett, presently with the Arch Insurance Agency and Mrs. Margaret Ellen Widmar, presently with the Dorsett Plastics Company. With these additions to our staff, we will be able to give you the best service possible on any type of insurance. If you have any questions regarding the existing insurance coverage or any other insurance problems, please do not hesitate to call on us.

Bernice Arch Teghtmeyer also sent one letter, which was comparable in content, to her insureds, advising them of the sale.

(i) Mrs. Teghtmeyer reported the sales transaction for Federal income tax purposes in the following manner:

> (1) The amount paid for the covenant not to compete was treated as ordinary income;
> (2) The amount paid as interest was treated as ordinary income; and
> (3) The remaining amount, after being decreased by the basis of the business, was treated as capital gain.

V.

6. (a) Of the expirations purchased from the Arch Insurance Agency, 60 percent represented policies expiring 1 year from the date of sale; 35 percent represented installment policies expiring 3 years from the date of sale; and 5 percent represented prepaid policies expiring 3 years from the date of sale.

(b) Miller & Sons' treatment of the expirations purchased from the Arch Insurance Agency was as follows: For each expiration, three labels, each identical, were made. Each contained the name of the insured, address, type of insurance, premium, insurance carrier, billing date, and expiration date. One label was attached to an envelope into which the expiration was inserted. This was filed alphabetically. The second

label, fastened to a 3-inch x 5-inch card, was filed alphabetically. The third label was filed alphabetically by month of expiration. The expirations were then used prior to each respective expiration date to solicit a renewal. If a policy was not renewed, no further use was made of an expiration.

(c) Miller & Sons' loss of renewal experience with respect to the 1,383 Arch Insurance Agency expirations was:

	1966	1967	1968	1969	1970	1971
January		13	14	5	4	2
February		28	4	7	3	2
March		18	5	8	6	4
April		27	12	2	3	3
May	*13	13	12	7	5	4
June	20	18	12	16	5	1
July	21	18	7	12	2	1
August	16	20	9	3	4	7
September	10	23	10	11	2	5
October	16	10	7	10	2	6
November	20	13	9	14	3	4
December	15	13	6	6	5	1
Total	131	214	107	101	44	40

*Between May 1, 1966, and approximately April 30, 1968, Miller & Sons lost an additional 165 policies which cannot be pinpointed by month and year.

(d) With respect to the 844 accounts, as distinguished from policies, that were contained in the acquired expirations, Miller & Sons' loss of renewal experience was as follows:

Calendar Year:	Accounts Not Renewed
1966 (from May 1)	122
1967	161
1968	52
1969	45
1970	28
1971	19
Total	427

At the end of 1967, a total of 283 accounts (33.53 percent) had been lost; at the end of 1971, a total of 427 accounts (50.59 percent) had been lost and 417 accounts (49.41 percent) remained active.

(e) In the period from May 1, 1966, through December 31, 1968, a total of 617 policies (44.61 percent) were not renewed. From May 1, 1966, to January 1, 1972, Miller & Sons did not renew 802 (57.99 percent) of the 1,383 policies contained in the acquired expirations. On January 1, 1972, 581 (42.01 percent) of the 1,383 policies had been renewed.

(f) For each 12-month period after the May 1, 1966, acquisition date, loss experience was as follows:

Period	Number of Policies	Percentage
May 1966–April 1967	*217	15.69
May 1967–April 1968	*163	11.79
May 1968–April 1969	94	6.80
May 1969–April 1970	95	6.87
May 1970–April 1971	39	2.82
Subtotal	608	43.96
(May 1966–April 1968)	165	
Total	773	55.89

*Does not include 165 policies lost in the period May 1, 1966, through April 30, 1968, but not identified by month and year.

(g) In the period May 1966 through April 1968, a total of 545 (39.41 percent) of the policies were not renewed, and the average annual nonrenewal rate in this period was 19.7 percent. For the 5-year period May 1966 through April 30, 1971, the average annual nonrenewal rate of policies in the Arch expirations was 11.2 percent.

(h) Miller & Sons' gain and loss experience on all policies in the period January 1970 through April 1974 is as follows:

Year	Policies Lost	Policies Gained	Net Policies	Nonrenewal rate
1970	207	231	2,224	9.3
1971	237	261	2,248	10.5
1972	248	282	2,281	10.9
1973	226	325	2,380	9.5
1974 (4 mos.)	79	119	2,420	3.25 (9.8 annually)
Average				10.0

VI.

7. (a) The $61,174.92 principal amount paid by Miller & Sons was for two kinds of intangible assets: (1) goodwill or property in the nature of goodwill, and (2) the information in the 1,383 expirations and accompanying records. Goodwill is an intangible asset with an indeterminate useful life; the useful life of the asset comprised of the 1,383 expirations is reasonably determinable and its value is severable from the value of the goodwill.

(b) Acquisition of the 1,383 expirations by purchase was equivalent to the substitution by Miller & Sons of the sums that would have been required to generate an equivalent amount of new business by internal growth.

(c) The goodwill transferred by the Arch Insurance Agency in this sale was an asset of value. Between 1961 and

March 1966, Arch Insurance Agency had a stable growth pattern and its gross commissions on policies at the time of the sale exceeded the gross commissions of Miller & Sons. By the purchase of the Arch Insurance Agency, Miller & Sons more than doubled its gross commissions from $28,328 in 1965 to $63,399 in 1967.

(d) Miller & Sons has no records nor information to establish the number of new policies written in the years 1966, 1967, 1968, or 1969. In the years 1970 through 1973, Miller & Sons wrote a total of 1,099 new policies; expenses allocated for the development of this new business totaled $37,865. The weighted average cost per policy written during this period equals $34.45.

(e) The following table shows the derivation of the weighted average cost for a new policy written during the period 1970–73, inclusive:

Date	Number of Policies	Insurance Expense*	16.6% Allocation	Average Cost Per Policy
1970	231	$52,046	$8,640	$37.40
1971	261	50,873	8,445	32.36
1972	282	57,948	9,619	34.11
1973	325	67,235	11,161	34.34
	1,099	228,102	37,865	

4-year average: $34.55.
Weighted average: $34.45.

*Includes a 5 percent reduction.

The value of the 1,383 expirations on the basis of a simple 4-year average ($34.55) would be $47,782.65, and on the basis of a weighted average ($34.45), the value would be $47,644.35.

ULTIMATE FINDINGS

8. (a) The 1,383 Arch expirations purchased by Miller & Sons constituted an intangible business asset which would have been exhausted in 5.08 years at the May 1966–April 1968 nonrenewal rate, and in 8.92 years at the May 1966–April 1971 nonrenewal rate. The reasonably determinable useful life of the 1,383 Arch expirations is not more than 10 years from the date of purchase on May 1, 1966.

(b) Miller & Sons would have incurred $47,644.35 to develop by internal growth 1,383 policies, the number in the expirations. The value of the goodwill purchased from Arch was $13,530.57; the value of the intangible asset represented

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by the 1,383 expirations and subject to depreciation was $47,644.35.

CONCLUSION OF LAW

Upon the trial judge's findings and opinion, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiffs are entitled to an allowance for depreciation of the intangible asset represented by the insurance expirations purchased from the Arch Insurance Agency in 1966, and that this intangible asset has a useful life of not more than 10 years and a value of $47,644.35. Plaintiffs have overpaid their Federal income taxes for the years 1966, 1967, 1968, and 1969 and are entitled to refunds of this overpayment, plus interest, as allowed by law. This case is remanded to the Trial Division for further proceedings pursuant to Rule 131(c).

In accordance with the opinion of the court, a memorandum report of the trial judge and a stipulation of the parties as to the amounts due thereunder, it was ordered on September 3, 1976 that judgments for the following plaintiffs be entered:

Richard S. and Edith V. Miller $2,426.86
Douglass W. and Joyce M. Miller $1,032.41
Daniel L. & Janis R. Miller $611.91

plus interest as provided by law.

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536 F. 2d 369

J. R. YOUNGDALE CONSTRUCTION CO., INC. v. THE UNITED STATES

[No. 92-73. Decided June 16, 1976]

OPINION

Contracts; disputes; untimely administrative appeal; waiver of 30-day-appeal period.—Plaintiff contracted to construct barracks for enlisted men at the Naval Auxiliary Air Station, Fallon, Nevada. The contract contained the standard Disputes clause. Plaintiff's appeal from an adverse decision of the contracting officer was dismissed by the Armed Services Board of Contract Appeals as un-

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timely, and thereafter plaintiff asked this court to review the Board's action under Wunderlich Act standards. In a decision reported at 205 Ct. Cl. 578, 504 F. 2d 1124 (1974), the court held that the Board had the power, under proper circumstances, to waive the 6-day delay in mailing the appeal, and remanded the case to the Board for determination of whether a waiver was warranted and, if so, determination of plaintiff's claim on the merits. The Board concluded that plaintiff had not shown any sound ground for a discretionary waiver and dismissed the appeal. The case is again before the court seeking reversal of the Board's action and a trial de novo on the merits. As the decision concerning waiver could reasonably have gone either way under the facts presented to the Board, it is *held* that the Board did not abuse its discretion in denying the request for a waiver. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Contracts; disputes; appeal; waiver of delay in filing appeal.

[1] As the agency delayed 19 months before furnishing plaintiff an appealable decision from the contracting officer, and plaintiff informed the agency in writing and orally of its intention to appeal the decision, and the Government was not prejudiced by plaintiff's 6-day delay in filing an appeal, a waiver of the 6-day delay would be permissible. On the other hand, absent a persuasive reason why plaintiff delayed until the end of the 30-day appeal period prescribed in the contract to instruct its counsel located across the country to prepare an appeal, it would be reasonable to infer that the delay was attributable to carelessness on plaintiff's part; and the fact that the Christmas holidays occurred near the end of the 30-day period would not be sufficient to excuse the delay. Under the circumstances, the contract appeals board was not required to exercise its discretion in favor of a waiver of the delay.

United States ⇐ 74(1)

Contracts; disputes; administrative decision; scope of review of Court of Claims; waiver of 30-day appeal period.

[2] Since the power of the contract appeals board to waive a delay in the filing of an appeal from a decision of the contracting officer is discretionary, this court's standard in reviewing denial of a waiver is not whether the court itself, upon consideration of the pertinent facts, believes that a waiver would be justified, but rather is whether the Board abused its discretionary power by exercising such power in an arbitrary manner.

Courts ⇐ 465

O. P. Easterwood, Jr., attorney of record, for plaintiff. *McNutt, Dudley, Easterwood & Losch*, of counsel.

Michael J. Rubin, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Opinion of Trial Judge

Before NICHOLS, KUNZIG, and BENNETT, *Judges.*

PER CURIAM: This case comes before the court on plaintiff's request, filed December 17, 1975, for review by the court of the recommended decision, filed December 1, 1975, by Senior Trial Judge Mastin G. White, pursuant to Rule 166(c) on plaintiff's motion for summary judgment and defendant's supplement to its cross-motion for summary judgment, having been submitted on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended decision, as hereinafter set forth, it hereby affirms and adopts the same as the basis for its judgment in this case. Accordingly, plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted and the petition is dismissed.

OPINION OF TRIAL JUDGE

WHITE, *Senior Trial Judge:* This case involves attempts—all unsuccessful thus far—by the plaintiff to obtain a decision, either by the Armed Services Board of Contract Appeals ("ASBCA") or by this court, on the merits of the plaintiff's claim for additional compensation under a contract with the Navy Department.

The plaintiff's initial appeal to the ASBCA from an unfavorable determination by the contracting officer on the plaintiff's claim was dismissed by the ASBCA in a decision dated February 28, 1973 (ASBCA No. 18090). The basis for the 1973 decision was that the appeal had been mailed by the plaintiff 6 days after the expiration of the 30-day period prescribed in the "disputes" provision of the contract for the taking of appeals by the contractor from adverse determinations by the contracting officer. In this connection, the ASBCA stated in its decision that it was "without authority to decide untimely appeals on the merits."

The plaintiff thereafter filed its petition in this court on March 14, 1973, and asked the court to review the action of the ASBCA under the provisions of the Wunderlich Act (41 U.S.C. §§ 321, 322). In a decision dated October 23, 1974 (205 Ct. Cl. 578, 504 F. 2d 1124), on a motion by the plaintiff and a cross-motion by the defendant for summary judgment, the

court held that the ASBCA had the power, under proper circumstances, to waive the tardy mailing of the plaintiff's appeal. Accordingly, the court denied the motions for summary judgment without prejudice and remanded the case to the ASBCA "for a determination, in the first instance, as to whether a waiver of the plaintiff's 6-day delay in mailing the appeal is warranted, and, if such waiver is granted, for a determination on the merits of the plaintiff's * * * claim."

The ASBCA's decision on the remand was dated February 24, 1975 (ASBCA No. 18090). It was the ASBCA's conclusion that "appellant [plaintiff here] has not shown any sound ground for a discretionary waiver of its failure to file a timely appeal." Accordingly, the appeal was dismissed by the ASBCA a second time.

The case is again before the court on a renewal by the plaintiff and the defendant of their motion and cross-motion, respectively, for summary judgment. In its motion for summary judgment, the plaintiff asks the court, first, to overrule the ASBCA's action in refusing to waive the 6-day delay in taking the appeal from the contracting officer's determination, and, second, to order the holding of a trial *de novo* in the court's trial division on the merits of the plaintiff's claim, since (according to the plaintiff) the administrative procedure has proved to be inadequate.

The factual information that was before the ASBCA on the remand will be summarized in subsequent paragraphs of this opinion.

The contract that is involved in the litigation called for the construction by the plaintiff for the Navy Department of enlisted men's barracks at the Naval Auxiliary Air Station, Fallon, Nevada. The plaintiff was to be paid a fixed price of $1,504,500 for the work. The contract contained in general provision 6 the standard provision relative to disputes, which stated in part as follows:

> (a) * * * [A]ny dispute concerning a question of fact arising under this contract which is not disposed of by agreement shall be decided by the Contracting Officer, who shall reduce his decision to writing and mail or otherwise furnish a copy thereof to the Contractor. The decision of the Contracting Officer shall be final and conclusive unless, within 30 days from the date of receipt

of such copy, the Contractor mails or otherwise furnishes to the Contracting Officer a written appeal addressed to the head of the agency involved. * * *

During the course of the performance of the work under the contract, a controversy arose between the plaintiff and the Navy Department's resident officer on the job as to whether, as proposed by the plaintiff on January 29, 1971, it was permissible under the contract specifications to use "a naturalite material" as aggregate in the production of the lightweight concrete that was needed for the project. On April 8, 1971, the resident officer disapproved the plaintiff's proposal on the ground that natural aggregate would not comply with the contract specifications; and he directed the plaintiff to use man-made aggregate instead of natural aggregate in the production of lightweight concrete.

The plaintiff complied under protest with the resident officer's directive that man-made aggregate must be used in the production of lightweight concrete; and the plaintiff informed the resident officer in a telegram that "All costs incurred as a result of Governments action * * * will be submitted as soon as same are ascertainable * * *."

In a letter which the plaintiff wrote to the resident officer on April 28, 1971, the plaintiff requested that a change order be issued to cover the additional expense allegedly incurred because of the requirement that man-made aggregate be used for lightweight concrete, and the plaintiff also requested a 30-day extension of the time prescribed in the contract for the completion of the work. Accompanying this letter was a detailed statement of the additional costs claimed by the plaintiff, totalling $20,728.

On August 26, 1971, and again on November 19, 1971, the plaintiff wrote the resident officer and inquired about the status of the plaintiff's claim. The letter of November 19 noted that no response to the plaintiff's earlier letters had been received, and that the claim had been pending for 7 months.

On December 8, 1971, the Officer in Charge of Construction, Western Division, Naval Facilities Engineering Command, at San Bruno, California, wrote to the plaintiff and denied the plaintiff's claim for additional compensation in

the amount of $20,728, and also the claim for a 30-day time extension. The letter discussed the claim in detail, stated that the decision contained in the letter was "the decision of the Officer in Charge of Construction and may be referred to the Contracting Officer for final decision in accordance with the Disputes Clause of the contract," and further stated that any request for a final decision should be sent through the San Bruno office to the Commander of the Naval Facilities Engineering Command in Washington, D.C.

On December 29, 1971, the plaintiff wrote a letter to the Commander of the Naval Facilities Engineering Command in Washington, D.C., requesting reconsideration of the claim which the plaintiff had submitted on April 28, 1971, "together with the supplemental costs attached hereto." The supplemental claim was for an additional amount of $15,493 and covered winter protection expenses allegedly resulting from the Government's delay in acting on the plaintiff's proposal of January 29, 1971, for the use of natural aggregate in the production of lightweight concrete. The letter of December 29, 1971, and attached supplementary claim were mailed to the Navy's San Bruno office for transmission to Washington, D.C., in accordance with the instructions previously received by the plaintiff from the San Bruno office.

On March 1, 1972, the plaintiff wrote another letter to the Commander of the Naval Facilities Engineering Command in Washington, D.C., inquiring about the status of the plaintiff's claim. This letter was also mailed to the Navy's San Bruno office for transmission to Washington, D.C.

By means of a letter dated March 14, 1972, the Navy's San Bruno office informed the plaintiff that its claim had been forwarded to Washington, D.C., for a decision by the contracting officer.

In the summer of 1972, the plaintiff and the Navy agreed on a settlement of the plaintiff's supplemental claim for delay expenses, which had been submitted with the plaintiff's letter of December 29, 1971. Under the settlement, the plaintiff received $11,935 and was allowed a 26-day time extension. It was understood by the parties that this settlement of the delay claim did not affect the plaintiff's aggregate claim.

Opinion of Trial Judge

In a letter which the plaintiff wrote to the Navy's San Bruno office on August 29, 1972, the plaintiff reminded the Navy that its aggregate claim was still pending, despite the settlement of the plaintiff's supplemental claim for delay expenses. The final paragraph of the letter dated August 29, 1972, stated that "we therefore respectfully request a formal decision of the Contracting Officer so as to allow this company to appeal to higher authority."

On November 21, 1972, the contracting officer (who was the Assistant Commander for Contracts of the Naval Facilities Engineering Command in Washington, D.C.) rendered a "final decision" denying the plaintiff's aggregate claim. A copy of this decision was mailed to the plaintiff and it was received by a receptionist in the plaintiff's San Diego, California, office on Monday, November 27, 1972.

Later in the week of November 27, 1972, the copy of the contracting officer's "final decision" was brought to the attention of Jack W. Brannen, the plaintiff's vice president in charge of contract matters. Immediately after reading the decision, Mr. Brannen called someone at the Navy's San Bruno office on the telephone (the identity of the individual called is not disclosed by the record) and informed him orally that the plaintiff was appealing from the adverse decision rendered by the contracting officer on the plaintiff's aggregate claim.

Sometime in the latter part of December 1972, Mr. Brannen in California wrote a letter to the plaintiff's counsel in Washington, D.C., transmitting the necessary papers for the preparation of an appeal from the contracting officer's decision of November 21, 1972, and instructing counsel to prepare such an appeal. The record does not disclose the exact date on which Mr. Brannen's letter was mailed or when it was received by counsel in Washington, D.C.

A written appeal from the contracting officer's decision was prepared by plaintiff's counsel, and the appeal was mailed on January 2, 1973. That was 6 days after the expiration of the 30-day period prescribed in general provision 6 of the contract for the mailing of such appeal.

On the basis of the factual information previously summarized in this opinion, the ASBCA decided that the plain-

tiff had "not shown any sound ground for a discretionary waiver of its failure to file a timely appeal"; and the ASBCA dismissed the appeal.

In view of the circumstances (1) that the Navy Department delayed for approximately 19 months before it furnished the plaintiff an appealable decision by the contracting officer on the plaintiff's claim of April 28, 1971, (2) that the Navy Department was informed by the plaintiff in writing as early as August 29, 1972, that the plaintiff intended to appeal from the decision of the contracting officer, if adverse when rendered, (3) that the plaintiff, promptly after receiving the contracting officer's decision, orally informed the Navy Department that the plaintiff was appealing from such decision, and (4) that no prejudice to the Navy Department resulting from the plaintiff's delay in taking the appeal has been shown, it could reasonably have been concluded by the ASBCA that a waiver of the plaintiff's relatively slight 6-day delay in mailing the appeal would be justified.

On the other hand, the plaintiff did not present to the ASBCA any persuasive reason why the plaintiff's vice president in charge of contract matters delayed until almost the end—and, indeed, perhaps until after the end—of the 30-day period prescribed by the contract for the taking of an appeal before he mailed the necessary papers and instructions from California to plaintiff's counsel in Washington, D.C. In the absence of some justifiable excuse—and the mere fact that the Christmas holidays occurred near the end of the 30-day period is insufficient for this purpose—it would be reasonable to infer that the delay was attributable to carelessness on the part of the plaintiff's vice president. In view of this, it certainly cannot be concluded that the ASBCA was *required* to exercise its discretion in favor of a waiver of the 6-day delay that occurred in the taking of the plaintiff's appeal.

Since the ASBCA's power to waive the 6-day delay was discretionary, the court's standard in reviewing the ASBCA's decision on the matter is not whether the court itself, upon a consideration of the pertinent facts, believes that a waiver of the 6-day delay would be justified. Rather, the proper standard is whether the ASBCA abused its discretionary power by exercising such power in an arbitrary manner.

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Inasmuch as the decision to waive or not to waive the 6-day delay could reasonably have gone either way under the facts presented to the ASBCA, there was no abuse of discretion on the part of the ASBCA in denying the request for a waiver.

CONCLUSION

Accordingly, the plaintiff's motion for summary judgment is denied, the defendant's cross-motion for summary judgment is allowed, and the petition is dismissed.

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538 F. 2d 865

DUANE BARNES (1); LESTER FITCH (2); EARLE GREEN (3); ALVIN S. HANZLIK (4); WAYMOND D. HANZLIK (5); LYLE H. JOHNSON (6); LOUIS JURACEK (7); FELIX MOTACEK (8); HENRY MOTACEK (9); AND JERRE D. SWANSON (10) v. THE UNITED STATES

No. 878-71

LEONARD NIELSEN v. THE UNITED STATES

No. 90-73

LOUIS J. SVOBODA AND JACQUELINE G. SVOBODA v. THE UNITED STATES

No. 237-73

ALVIN S. HANZLIK (1); WAYMOND D. HANZLIK (2); LYLE H. JOHNSON (3); FELIX MOTACEK (4); CURTIS SNOWDON (5); DONALD E. SNOWDON (6); AND DOROTHY SWANSON (7) v. THE UNITED STATES

No. 340-73

[Decided July 9, 1976]

OPINION

Eminent domain; taking; just compensation; flowage easement; taking date; crops damage.—In these consolidated inverse condemnation cases, before the court on stipulated facts, plaintiffs as owners

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of land, or crops thereon, situated adjacent to the confluence of the Missouri and Niobrara Rivers, allege that defendant's construction and operation of the Fort Randall and Gavins Point Dams on the Missouri River caused a delta of sediment from the Niobrara River of unprecedented size to form at the mouth of the Niobrara River so that flow of the Missouri River was altered, the sediment was no longer washed away as theretofore, and upon sustained releases of excess water accumulations from the Fort Randall Dam their lands have been inundated or waterlogged by seepage, thus resulting in a Fifth Amendment taking of the lands and/or crops. On the basis of the stipulated facts, it is *held* (1) that the Government took a flowage easement appurtenant to the lands of plaintiffs-landowners but did not take the fee in any land, and also took property from those plaintiffs who are owners of crops alone; (2) that November 30, 1973 is the best date of taking when, through passage of time, the permanent character of intermittent flooding became apparent; and (3) that this court does not have statutory jurisdiction to make an award for crops damage sustained prior to the found taking date. Judgment is entered for plaintiffs on liability. The case is remanded to the Trial Division for further proceedings on damages, the damage award being contingent upon execution and delivery to defendant of deeds conveying a perpetual easement to flood plaintiffs' lands in issue, if defendant so desires it. The Trial Division is directed to consider whether, and if so to what extent, plaintiffs are entitled to recover litigation expenses incurred pursuant to 42 U.S.C. § 4654 (1970).

Eminent domain; taking; what constitutes.

[1] Generally, property may be taken by the invasion of water where subjected to intermittent, but inevitably recurring, frequent inundation due to authorized Government action. A constitutional taking resulting from such flooding is not limited to instances of obvious overflowing of a river's bank but may include percolation or rising ground water, or where Government-induced deposition of sediment in a riverbed causes the river to overflow its banks.

Eminent Domain ⟸ 27

Eminent domain; taking; compensability; consequential damages not compensable.

[2] Government-induced flooding not proved to be inevitably recurring occupies the category of mere consequential injury, or tort. In such cases recovery is not authorized in the Court of Claims.

Eminent Domain ⟸ 90

Eminent domain; taking; what constitutes.

[3] Flood waters which effect a taking must rise above the ordinary high-water mark of the navigable river involved, for the action of water within the limits of the riverbed may be altered by the Government without liability in the exercise of the dominant servitude.

Eminent Domain ⟸ 27

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Eminent domain; taking; what constitutes.

[4] In a suit charging a constitutional taking by reason of Government-induced flooding of property, a claimant need not allege or prove that the Government specifically intended to take property. There need be only a governmental act, the natural and probable consequences of which effect such an enduring invasion of plaintiff's property as to satisfy all other elements of a compensable taking. The Government may take less than the entire fee interest in the land.

Eminent Domain ⟸ 195

Eminent domain; taking; what constitutes; flooding.

[5] Where, as a natural consequence of the closing of the Fort Randall and Gavins Point Dams, a sedimentary delta of unprecedent magnitude formed at the mouth of the Niobrara River in the Missouri River channel which remained stable over a period of years and restricted the channel-carrying capacity of the Missouri River, and where releases on a sustained basis from the Fort Randall Dam to evacuate excess water accumulations inundated two-thirds of plaintiffs' lands adjacent to and above the rivers' high-water marks and isolated or waterlogged by seepage the remaining lands or subjected them to impaired surface and subsurface drainage, the flooding was a natural consequence of delta growth and of defendant's acts.

Eminent Domain ⟸ 27

Eminent domain; taking; date of taking.

[6] Where the Government has brought about a taking by a continuing process of physical events, such as intermittent flooding of property, the owner is not required to resort either to piecemeal or to premature litigation to ascertain the just compensation for what has been taken, but may postpone suit until after establishment of a date when the permanent character of the flooding is fairly perceived. Adopting a date of taking must often be done in a somewhat imprecise manner—in the nature of a jury verdict.

Eminent Domain ⟸ 174

Eminent domain; just compensation; flowage easement; growing v. mature crops.

[7] Where the court has determined that as of a specific date defendant took a flowage easement appurtaining to plaintiffs' fee lands and crop interests, since, generally, inmature crops not ready for harvest constitute a part of the realty they cannot be valued separately therefrom. Realty must be valued as a whole, including any increment in value attributable to the immature crops. However, the value of mature crops ready for harvest at the date of taking represents a separate element of recoverable damages.

Eminent Domain ⟸ 132

Eminent domain; just compensation; pre-taking date compensation; crops damage.

[8] Where the court has determined that as of a specific date defendant took a flowage easement appurtaining to plaintiffs' fee lands and crop interests, crop damages sustained prior to the date of taking are the product of tortious invasions—mere trespasses, and are not recoverable in this court (28 U.S.C. § 1491 (1970)).

Eminent Domain ⇐ 132

Richard A. Spellman for plaintiffs and attorney of record for plaintiffs in No. 340–73. *William G. Campbell*, attorney of record for plaintiffs in Nos. 878–71, 90–73, and 237–73. *Kutak Rock Cohen Campbell Garfinkle & Woodward*, of counsel.

John E. Lindskold, with whom was *Assistant Attorney General Peter R. Taft*, for defendant.

Before NICHOLS, KUNZIG, and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

The parties in these four consolidated inverse condemnation actions, claiming almost $2 million, plus interest, attorney fees, and costs, have submitted the cases to us for decision under Rule 134(b), upon a stipulation of facts filed May 14, 1975, and a supplementary stipulation filed October 3, 1975. The court accepts these stipulations and adopts them as its findings of fact.[1] On the basis of the facts so found and the law, and for the reasons hereinafter set forth, we conclude that the plaintiffs are entitled to recover in amounts to be determined in further proceedings under Rule 131(c).[2]

At all relevant times plaintiffs were landowners of, or owners of crops on, riparian and nonriparian fast lands situated adjacent to the confluence of the Missouri and Niobrara Rivers, near the town of Niobrara, Knox County, Nebraska. At this point, the Missouri, a navigable river, flows in a generally southeasterly direction, some 36 miles downstream from the Fort Randall Dam. Thirty-three miles

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[1] Only those facts deemed material to the decision are set forth in this opinion.

[2] Case No. 878–71 is for taking of and damage to crops only. Case No. 90–73 claims a taking of and damage to crops, plus a taking of a flowage easement. Case No. 273–73 claims a total taking of land. Case No. 340–73 claims a taking of and damage to crops, plus a taking of a flowage easement.

further downstream one encounters the Gavins Point Dam, which since it began impounding water in Lewis and Clark Lake in 1955 has backed the reservoir all the way upstream to a point approximately 3 miles below the intersection of the two rivers. The Niobrara River empties into the Missouri in this vicinity with some considerable velocity, having followed a steeper course in its generally northerly flow.

For hundreds of years the swift currents of the Niobrara have deposited sediment near its mouth, and beyond—into the slower moving and relatively flat Missouri. These sediments from time to time have formed deltas of varying magnitude and duration in the Missouri River channel, either at or immediately downstream from the junction of the Missouri and the Niobrara. Prior to the construction and closing of the Fort Randall Dam in 1952, seasonal high flows of the Missouri River resulting from melting snow and rainfall would scour out and flush away, either partially or entirely, the sediment accumulations deposited by the Niobrara in the Missouri. Since that time, however, these seasonal high flows have been eliminated, and so too the periodic, natural removal of excess sedimentation.

The Government's engineering studies conducted in planning the Fort Randall and Gavins Point Dams indicated that the Niobrara's sediment load would continue to be deposited in the Missouri, but officials concluded that the rapid degradation of the Missouri River bed below the Fort Randall Dam would prevent undue accumulation, delta growth reaching equilibrium after 7 to 12 years. Likewise, the studies recognized that a principal effect of aggradation would be to raise the surface and groundwater elevations in the area of the town of Niobrara.

Due to the continuing deposition of sediment in the Missouri after the closing of the Fort Randall and Gavins Point Dams, by 1964 a delta of unprecedented magnitude became established in the Missouri River channel at the mouth of the Niobrara River. Its size remained stable between 1965 and 1969, vegetation becoming established in places and rendering that part of the delta more permanent than portions not affected by vegetation. Thus, the channel carrying capacity of the Missouri has become increasingly restricted

over the years. By 1967 the Niobrara delta had so restricted the channel of the Missouri as to reduce its carrying capacity to about 48,000 to 60,000 cubic feet per second (c.f.s.), or roughly 50 percent below its pre-1952 capacity.

Since 1969 releases have been made from the Fort Randall Dam to evacuate the excess water accumulation caused by rains and melting snows. Some of plaintiffs' lands experience marginal flooding damage, owing to backwater effect, when discharges are maintained at 30,000 c.f.s. Such damages occur on lower areas of the Swanson property (case Nos. 878–71 and 340–73) at discharges of 15,000–20,000 c.f.s. Sustaining damages occur on some of plaintiffs' lands at times when discharges are maintained above 40,000 c.f.s., as a result of water backing up old chutes or drainage ditches, seepage under land, and submergence of low, gently sloping channel banks. Such sustaining damage also results from restriction of surface and subsurface drainage. When Fort Randall Dam discharges are maintained at about 48,000 c.f.s., complete flooding appears on some of plaintiffs' lands.

The stipulation recites that prior to 1952, occasional flooding would result from the Missouri's seasonal high flows. However, the then adequate channel carrying capacity could accommodate the additional volume in a relatively short period of time, and crops could be planted and harvested the same year without substantial difficulty. For example, in 1952 when the "flood of record" occurred, the waters had receded sufficiently by April, and the rise in June and July did not exceed 66,500 c.f.s. A successful crop was planted and harvested the same year. Prior to 1952, plaintiffs' lands were never subjected to sustained high flows during mid-August, September, October, or November. Prior to that time plaintiffs never experienced high-water tables or surface or subsurface drainage problems. Plaintiffs' lands were then among the most productive agricultural lands in Knox County, Nebraska, being useful for grazing, and the growing of corn, alfalfa, winter wheat, sorghum, and milo. Additionally, some of the riparian lands had recreational value. The lands involved in these cases consist of approximately 2,775 acres of river bottomlands along the Missouri River and 48 acres along the Niobrara River.

Flooding problems of a more lasting character began for these plaintiffs in August and September 1969, when releases from Fort Randall Dam exceeded 50,000 c.f.s. on a sustained basis. Some 1,740 acres of bottomlands, more or less, were influenced by high waters, two-thirds of which were inundated by surface flooding. The remainder of the affected property was isolated or waterlogged by seepage, or subjected to impaired surface and subsurface drainage as well as raised groundwater table elevations. During the period between August and November of 1970, effects were experienced when releases from the Fort Randall Dam regularly surpassed 40,000 c.f.s. Surface and subsurface drainage was impeded. Plaintiffs' crop yields were reduced due to the fact that some of the acreage inundated in 1969 had not drained properly and remained waterlogged. Wetness rendered pasturelands largely useless.

While there was no bank overtopping in 1971, during the months of August through September of that year plaintiffs' lands were inundated by subsurface seepage, impaired drainage, and waters backing up into plaintiffs' creeks, chutes and drainage ditches. Gently sloping channel banks and other areas immediately adjacent to the Missouri banks were submerged. Releases during this period commonly were 47,000 c.f.s. Pasturelands were unusable; crop yields were reduced and some standing crops had to be destroyed. Flooding in August through November of 1972 approximated that of the same months in 1971. During the comparable period in 1973, releases from the Fort Randall Dam and the flow of the Missouri by plaintiffs' lands did not exceed 36,300 c.f.s. except for short periods. However, it is undisputed that as a result of the sustained high releases from Fort Randall Dam in 1969 through 1973, the elevation of the groundwater table beneath plaintiffs' lands has been raised to within 0 to 3 feet beneath the surface. The supplementary stipulation reveals that sustained releases from the Fort Randall Dam from late July through October 1975 reached 60,000 c.f.s., increasing the adverse effects previously described. Further, the presence of higher groundwater manifests itself through destruction of the land for pasture purposes, extensive cattail growth, killing of trees, rotting of crops, failure of seeds

to germinate, and inability to use farm machinery on the land. It is not open to doubt upon this record that the underlying cause of the flooding problems experienced by plaintiffs is the control, storage and regulation of the flow of the Missouri River by the construction and operation of the main stem reservoir system of the Missouri River, of which the Fort Randall Dam is a part. Additionally, we are satisfied that the damaged land and crops were situated above the pre-1969 established ordinary high-water marks of the Missouri and Niobrara Rivers.

Finally, the parties have stipulated that, in the future, sustained releases from the Fort Randall Dam during the period August–November of each year may be estimated to exceed 50,000 c.f.s. in one year out of five. Releases on a sustained basis of 47,000 c.f.s. can be expected one year out of four, and continuing releases of 40,000 c.f.s. probably will occur one year out of three. Thus, the facts warrant the finding that the flooding which typified the period from 1969 to 1973 will continue indefinitely.

The parties have placed before us three separate questions. First, we must decide whether plaintiffs' lands and/or crops, or any interest therein, were taken for public use within the meaning of the fifth amendment to the Constitution. If some interest was taken, we then must inquire as to the appropriate date of taking for purposes of figuring just compensation. Finally, if we decide that the relevant date is in 1973, as contended by plaintiffs, and not 1969 as defendant would have it, we must resolve the problem of whether the fifth amendment authorizes an award for loss of crops in years prior to the date of taking selected.

I

The fifth amendment to the Constitution of the United States provides, in part: "* * * nor shall private property be taken for public use, without just compensation." Over the years the decisions have developed the law of eminent domain as applied to instances of flooding. Generally speaking, property may be taken by the invasion of water where subjected to intermittent, but inevitably recurring, inundation due to authorized Government action. *United States* v. *Cress*, 243

U.S. 316 (1917). We have so held in numerous cases, *e.g.*, *Hartwig* v. *United States*, 202 Ct. Cl. 801, 809, 485 F. 2d 615, 619–20 (1973); *King* v. *United States*, 192 Ct. Cl. 548, 551–52, 427 F. 2d 767, 769 (1970); *Fromme* v. *United States*, 188 Ct. Cl. 1112, 1118, 412 F. 2d 1192, 1196 (1969); *National By-Products, Inc.* v. *United States*, 186 Ct. Cl. 546, 576, 405 F. 2d 1256, 1273 (1969); *B Amusement Co.* v. *United States*, 148 Ct. Cl. 337, 341–42, 180 F. Supp. 386, 389 (1960); *North Counties Hydro-Elec. Co.* v. *United States*, 138 Ct. Cl. 380, 383, 151 F. Supp. 322, 323, *cert. denied*, 355 U.S. 882 (1957). A constitutional taking resulting from such flooding is not limited to instances of obvious overflowing of a river's banks. The just compensation clause of the fifth amendment has been found likewise applicable in cases of percolation or rising ground water. *United States* v. *Kansas City Life Ins. Co.*, 339 U.S. 799 (1950). A taking may result where Government-induced deposition of sediment in a riverbed causes the river to overflow its banks. *Cotton Land Co.* v. *United States*, 109 Ct. Cl. 816, 75 F. Supp. 232 (1948). The cases disclose the rule that the permanent, intermittent flooding which amounts to a taking must be frequent, *Fromme* v. *United States*, *supra*, 188 Ct. Cl. at 1118–119, 412 F. 2d at 1196–197, and productive of substantial damage, *United States* v. *Cress*, *supra* at 328. Government-induced flooding not proved to be inevitably recurring occupies the category of mere consequential injury, or tort. In such cases recovery is not authorized in this court. 28 U.S.C. § 1491 (1970); *Sanguinetti* v. *United States*, 264 U.S. 146 (1924); *Bedford* v. *United States*, 192 U.S. 217, 225 (1904); *Hartwig* v. *United States*, *supra*; *National By-Products, Inc.* v. *United States*, *supra*; *Columbia Basin Orchard* v. *United States*, 132 Ct. Cl. 445, 452, 132 F. Supp. 707, 710–11 (1955).

Additionally, the waters which effect the taking must rise above the ordinary high-water mark of the navigable river involved, for the action of water within the limits of the riverbed may be altered by the Government without liability in the exercise of what has come to be known as a "dominant servitude." *United States* v. *Twin City Power Co.*, 350 U.S. 222 (1956); *United States* v. *Willow River Power Co.*, 324 U.S. 499, 509 (1945).

Finally, in cases such as these, plaintiffs need not allege or prove that defendant specifically intended to take property. There need be only a governmental act, the natural and probable consequences of which effect such an enduring invasion of plaintiffs' property as to satisfy all other elements of a compensable taking. *Richard* v. *United States*, 152 Ct. Cl. 225, 230, 282 F. 2d 901, 904 (1960), *modified on other grounds*, 152 Ct. Cl. 266, 285 F. 2d 129 (1961); *B Amusement Co.* v. *United States*, *supra; Biggs Rental Co.* v. *United States*, 173 Ct. Cl. 789, 353 F. 2d 1013 (1965); *Cotton Land Co.* v. *United States*, *supra*, 109 Ct. Cl. at 831–32, 75 F. Supp. at 235. It has often been held that the Government may take less than the entire fee interest in real property. As the Supreme Court put it in *Cress*, *supra:*

> * * * where * * * it appears that less than the whole has been taken and is to be paid for, such a right or interest will be deemed to pass as is necessary fairly to effectuate the purpose of the taking; and where * * * land is not constantly but only at intervals overflowed, the fee may be permitted to remain in the owner, subject to an easement in the United States to overflow it with water as often as necessarily may result from the operation of the * * * [Government activity]. [243 U.S. at 329.]

Accord, *King* v. *United States*, 205 Ct. Cl. 512, 504 F. 2d 1138 (1974) (flowage easement); *Richard* v. *United States*, *supra* (seepage easement).

Defendant resists plaintiffs' claims principally by referring us to this court's decision in *Pitman* v. *United States*, 198 Ct. Cl. 82, 457 F. 2d 975 (1972). There the plaintiff owned oceanfront property in Florida. The force of the Atlantic Ocean over the years had not eroded his beach because of the prevailing southern littoral drift in the area, which would regularly replenish what sand was swept away by the currents. In the course of opening a harbor entrance to the north of plaintiff's property, the Corps of Engineers constructed two jetties at the entrance channel. These structures deprived plaintiff's property of the replenishment of sand provided by the southern littoral drift, and thereby caused the beach to be eroded. After the ocean had claimed some 4 acres of his land plaintiff constructed a seawall and

groin, and brought suit here for just compensation. Chief Judge Cowen, speaking for the full court, held that the petition should be dismissed since none of plaintiff's property was taken in the constitutional sense. The plaintiff had no property right in the uninterrupted and natural flow of the Atlantic Ocean, 198 Ct. Cl. at 85, 457 F. 2d at 976, and neither alleged nor proved that defendant raised the level of the Atlantic Ocean above the high-water mark thereby permanently inundating his land. 198 Ct. Cl. at 87, 457 F. 2d at 977. The court took care to distinguish *Cress*, *supra*, and cases in that line. For that reason the *Pitman* case provides no obstacle whatever to plaintiffs' recovery in the instant cases. *Pitman* was an erosion case; not a flooding case. The damage to plaintiff's property there was occasioned strictly as a consequence of the Government's exercise of the dominant servitude—"the paramount power of the United States to improve navigation." 198 Ct. Cl. at 86, 457 F. 2d at 977.

We think *Cotton Land Co.* v. *United States*, *supra*, provides an apt precedent for plaintiffs' recovery. The plaintiff corporation's riparian land was situated along a 16-mile stretch beginning 86 miles downstream from the Hoover Dam on the Colorado River, and ending just over 53 miles upstream from the Parker Dam. Parker Dam began impounding water in 1938, and within several years had backed water up in a lake stretching all the way to a point within 4 or 5 miles to the south of plaintiff's property. The backwater effect of the Parker Dam caused the Colorado River to lose its velocity and, accordingly, to deposit sediment in its bed in close proximity to the plaintiff's property. As a natural consequence of this sedimentation, the riverbed and level of water were raised, causing significant flooding and damage for which plaintiff sought just compensation. We held for the plaintiff because, owing to authorized Government action,

> * * * a succession of events was initiated which, when the events had all occurred in their natural order, deprived the company of the beneficial use of its land. * * *. [109 Ct. Cl. at 828, 75 F. Supp. at 233.]

It was observed that where the damage is the natural consequence of governmental action, such damages are not "too remote," or consequential. 109 Ct. Cl. at 829, 75 F. Supp. at

233. All other elements of a compensable taking appeared as well.

Defendant attempted to distinguish *Cotton Land Co.* when pressed at the argument [3] by observing that in the cases now before the court, the backwater effect and flooding were immediately caused by the *delta*, and not as in *Cotton Land* by a downstream dam. If ever there was a distinction without a difference, this seems to be it. Moreover, the *Cotton Land* court stated that the sand deposits resulting from backwater effect "had the characteristics of a typical delta." 109 Ct. Cl. at 827, 75 F. Supp. at 233. The stipulation in these cases tells us that Government officials actually foresaw that delta growth would be a factor to consider in evaluating the impact of the Fort Randall and Gavins Point Dams. We are quite satisfied that the delta's unprecedented size and tenacity were natural consequences of the closing of the dams in the area, and that the flooding disclosed upon this record was a natural consequence of delta growth. As held in *Fromme* v. *United States*, *supra*, 188 Ct. Cl. at 1118, 412 F. 2d at 1196, it is immaterial whether the flooding caused by the Government is from a backwater effect or by the prevention of proper drainage. The result is the same if the effect is inevitably recurring.

Plaintiffs have fulfilled the remaining elements of legally sufficient inverse condemnation claims. While the flooding is intermittent, the experience of 1969 through 1973, and 1975,[4] together with future projections, show that the flooding is of a type which will be inevitably recurring. The flooding has been occasioned by authorized Government action for public use—construction and operation of the Fort Randall and Gavins Point Dams. The flooding has certainly been frequent enough and will continue to be sufficiently frequent to constitute a taking. Numerous photographs jointly placed in the record by the parties for our assistance bear graphic witness to the fact that the flooding has been productive of substan-

[3] Plaintiffs devoted a significant portion of their main brief to a discussion of *Cotton Land Co.*, and to us it is evident that this case was plaintiffs' principal authority. Defendant failed altogether to discuss *Cotton Land* in the briefs.

[4] The stipulations before us do not contain any facts relating to the flooding in 1974.

tial, sustained damage to land and crops. The flooding and attendant damage occurred above the ordinary high-water marks of the Missouri and Niobrara Rivers. The damage being the natural consequence of authorized Government action, the taking package is complete. We conclude, therefore, that defendant took a flowage easement appurtenant to the lands of the plaintiff landowners, but that it did not take the fee to any land. Likewise, we think defendant took property from those plaintiffs who are owners of crops alone, measured by the amount by which the value of their respective interests were diminished as of the date of taking.

Defendant has misconstrued plaintiffs' claims as being based upon an alleged and nonexisting property right against the United States in the unaltered flow of the Missouri River. On the contrary, plaintiffs base their case squarely on the fifth amendment and have alleged a taking of crops, land and a flowage easement because of the waters of the Missouri which flooded and invaded plaintiffs' lands "as a result of the construction and operation of the Missouri River dams." Plaintiffs have claimed and shown to the satisfaction of the court that operation of the dams has placed waters on and under their lands above and beyond the ordinary high-water mark of the Missouri River so as to decrease or destroy their value for agricultural purposes. Plaintiffs have acknowledged the dominant servitude of the Government in navigable waters, such as the Missouri River, but only as to property that is below and not beyond the ordinary high-water mark, as is their property in these cases. Their damage is thus not consequential but compensable for a taking. As above stated, the flooding damages suffered by the plaintiffs are the natural consequences of acts of the defendant, and the damages are permanent in character. The stipulation shows that defendant anticipated the creation of a delta and a rise in the groundwater elevations in the area.

II

It next becomes necessary to determine the appropriate date of taking, for purposes of fixing just compensation. Defendant proposes 1969, the first year of sustained flooding. Plaintiffs contend for 1973, taking the position that only then

could it be said with relative certainty that the flooding would be permanent.

In *United States* v. *Dickinson*, 331 U.S. 745 (1947), the Court faced this sort of question in deciding whether an inverse condemnation suit was barred by the statute of limitations. It was said:

> Property is taken in the constitutional sense when inroads are made upon an owner's use of it to an extent that, as between private parties, a servitude has been acquired either by agreement or in course of time. * * * The source of the entire claim—the overflow due to rises in the level of the river—is not a single event; it is continuous. And as there is nothing in reason, so there is nothing in legal doctrine, to preclude the law from meeting such a process by postponing suit until the situation becomes stabilized. * * *.
>
> * * * [W]hen the Government chooses not to condemn land but to bring about a taking by a continuing process of physical events, the owner is not required to resort either to piecemeal or to premature litigation to ascertain the just compensation for what is really "taken." * * *. [331 U.S. at 748–49.]

We have heretofore said that the date of taking is the date the Government enters into possession of the interest seized. *King* v. *United States*, *supra*, 205 Ct. Cl. at 518, 504 F. 2d at 1142. These principles are not inconsistent—the date of taking here is not in our view the date of the first flood in 1969, but rather in 1973 after it first became clearly apparent by the passage of time that the intermittent flooding was of a permanent nature. Adopting a date of taking must often be done in a somewhat imprecise manner, this aspect of the cases being in the nature of a jury verdict. *Drakes Bay Land Co.* v. *United States*, 191 Ct. Cl. 389, 414, 424 F. 2d 574, 587–88 (1970). The date selected obviously depends on the facts of each case, but the facts here lead us to the firm conclusion that the date the Government completed taking its flowage easement cannot be prior to when, through passage of time, the permanent character of intermittent flooding could fairly be perceived. We think that the best date that might be suggested within these limits is November 30, 1973, this being the final day of the August–November flooding which had occurred

in 1973, and in each of the previous years stretching back to 1969.

III

Having established November 30, 1973, as the date of taking, we are confronted with the question of whether on remand to the Trial Division the trial judge will be authorized to recommend any award for crop damage sustained by the plaintiffs during the period from 1969 through 1973. Plaintiffs earnestly contend that such an award would be correct, while defendant dismisses the argument as one which sounds strictly in tort.

While we conclude that a flowage easement was taken on November 30, 1973, we do not think that any award for crop damage sustained prior to that time may be permitted. The two principal cases cited by plaintiffs on this point may readily be distinguished. In *R. J. Widen Co.* v. *United States*, 174 Ct. Cl. 1020, 357 F. 2d 988 (1966), pursuant to an agreement with the United States, the Commonwealth of Massachusetts condemned the fee interest in plaintiff's land on July 2, 1957. A state court verdict led to judgment for just compensation for the fee so taken. Subsequently, the plaintiff brought suit here seeking additional compensation for what it termed a "temporary taking" by the United States between March 1957 and the formal date of taking by the Commonwealth of Massachusetts some 3 months later. In March of that year the contractor engaged by the Corps of Engineers had entered upon plaintiff's land and commenced work on a flood control project. The court held, in part, that plaintiff was entitled to additional just compensation measured by the fair rental value of the land between the relevant dates. 174 Ct. Cl. at 1032–033, 357 F. 2d at 996. The present cases are different in that they involve a single, nondivisible taking of an easement by only one sovereign—not two as in *Widen*. At most, the court said in *Widen* that the Federal Government took a separate and distinct term of 3 months, without regard to later condemnation of the fee by the State of Massachusetts. That case provides no authority for the position that separate crop damages may be awarded where one sovereign by continuously inflicting such

damage ultimately acquires a flowage easement through passage of time.

Likewise not in point is *Daily* v. *United States*, 116 Ct. Cl. 723, 90 F. Supp. 699 (1950). There, prior to formal condemnation proceedings in the district court, the Government entered upon land with the permission of the owner and the share crop tenant in possession, and commenced building an airport. A growing crop of gray banana squash was largely destroyed, for which damage plaintiffs sought and recovered just compensation. Our reading of the *Daily* opinion indicates that the court thought the whole property, real and personal, to have been taken all at once when the Government first placed itself in possession of the land. 116 Ct. Cl. at 733–34, 90 F. Supp. at 702–03. The court held only that the plaintiffs should be justly compensated for the taking of their crop growing on the land at the date of a de facto taking, July 20, 1942, this being the date the Government entered the land. *Daily* does not authorize us to conclude that where a taking occurs on a given date, trespass damages sustained at the hands of the Government before the taking may be bootstrapped onto the award of just compensation for the fee or other interest ultimately taken.

At argument, the Government conceded only that the value of the crop growing on the date of taking, if any, could be taken into account in further proceedings in determining the value to be assigned to the flowage easement. In our estimation, a growing but immature crop cannot properly be valued separately from the value of the realty itself, for as we previously have recognized, unsevered crops not ready for harvest as a general rule constitute a part of the realty. *Cf. King* v. *United States*, *supra*, 205 Ct. Cl. at 519, 504 F. 2d at 1142. The realty must be valued as a whole, including any increment in value attributable to the immature crops. In accord with our prior decisions, however, these plaintiffs, as their interests appear, may recover as a separate element of damages the value of mature crops, if any, ready for harvest at the date of taking. *Cf. id.* All of this will figure in the determination of the easement's value on remand. At best, crop damages sustained prior to the date of taking mentioned above are the product of tortious invasions—mere trespasses. Such damages are not recoverable in this court in any event.

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28 U.S.C. § 1491 (1970). Not until the date of taking did these several tortious invasions ripen to the extent necessary to confer on the defendant a flowage easement. For damages sustained prior to that moment, we have no statutory jurisdiction.

Judgment is hereby entered for plaintiffs on liability, it being held that on November 30, 1973, defendant took a flowage easement appurtaining to the fee lands and crop interests of these plaintiffs. An award of damages is contingent upon plaintiffs' executing and delivering to the defendant deeds conveying a perpetual easement to flood their lands in issue, if defendant so desires it. The cases are remanded to the Trial Division for further proceedings on the question of damages, in conformity with the foregoing opinion. As a part thereof the trial judge is directed also to consider whether, and if so to what extent, these plaintiffs are entitled to recover their litigation expenses incurred pursuant to 42 U.S.C. § 4654 (1970).

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537 F. 2d 457

SIDNEY J. HESS, JR., WILLIAM J. FRIEDMAN AND AMERICAN NATIONAL BANK AND TRUST COMPANY OF CHICAGO, AS SUCCESSOR CO-TRUSTEES OF THE RESIDUE TRUST FOR JOHN JACOB ETS HOKIN; SIDNEY J. HESS, JR., AND AMERICAN NATIONAL BANK AND TRUST COMPANY OF CHICAGO, AS SUCCESSOR CO-TRUSTEES OF THE RESIDUE TRUST FOR LYNDA SUE ETS HOKIN; JOHN JACOB ETS HOKIN AND LYNDA SUE ETS HOKIN McCRACKEN v. THE UNITED STATES

[No. 471-73. Decided July 9, 1976]

ON DEFENDANT'S MOTIONS FOR LEAVE TO AMEND ITS ANSWER AND FOR SUMMARY JUDGMENT

Taxes; income tax; gain or loss on disposition of property; basis of property acquired from decedent; estoppel/quasi-estoppel; amendment of pleadings; waiver of defense.—Plaintiffs seek refund of Federal income taxes paid by the estate of Barney Ets Hokin who died in 1962 for fiscal year ending May 31, 1965, and by the Inter-

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national Trust created by decedent's wife for her grandchild Lynda for 1965. The issue is whether the bases on which the gains are computed by both the estate and the International Trust are the amounts used in the estate tax valuation of the estates through which the stock passed to the taxpayers, or the then fair market value to be newly determined without regard to such amounts. On defendant's motion for leave to amend its answer to include the defense that plaintiffs are estopped from using a basis different from the estate tax valuation, it is *held* that defendant did not waive the estoppel defense and the motion is granted on the strength of Rules 39(a) and 39(b). It is also *held*, on the facts before the court, that the estate as well as the International Trust must use the value of the stock as reported on the Federal estate tax returns as the basis in computing gains on the subsequent redemption of the stock. Defendant's motion for summary judgment is also granted. The petition is dismissed.

Pleading and practice; defenses; when and how presented; waiver of defense; exception to rule of waiver.

[1] While under this court's Rule 37(b) the defense of estoppel must be affirmatively pleaded, Rule 39(a) allows amendment of the pleadings by leave of court "when justice so requires." Where plaintiffs have not demonstrated that they have been or will be prejudiced, other than incurring costs in discovery proceedings, and they have not been precluded from presenting their case and were aware that estoppel was an issue and that they would be able to brief and argue the point, under the circumstances mere delay is insufficient to bar amendment to include the estoppel defense. Furthermore, where the evidence before the court strongly indicates an estoppel, Rule 39(b) may be invoked to allow amendment to conform to the evidence. Rule 39(a) and 39(b) should be liberally construed.

Courts ⟸ 463

Pleading and practice; defenses; estoppel; legal estoppel.

[2] Inasmuch as defendant's estoppel defense to plaintiff's petition is based in large part on the Internal Revenue Code and Treasury Regulations, it is not merely an equitable defense but is more in the nature of a legal defense, and failure to raise in the answer the defense that plaintiffs should be estopped from arguing that the basis of the shares of stock in issue differed from the values used for federal estate tax purposes does not constitute waiver of the defense.

Courts ⟸ 463

Taxes; income tax; gain or loss on disposition of property; basis of property acquired from decedent; fair market value.

[3] Generally, the basis of property in the hands of a person acquiring the property from a decedent is the fair market value at the time of decedent's death or at the alternate value date if used, and this basis as adjusted, is used if the property is later sold, exchanged or redeemed in order to determine gain or loss. This fair market value is

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also the amount required to be reported on a taxpayer's federal estate tax return. However, the fair market value as of decedent's death or as of the alternate value date is not conclusive but is a presumptive value which may be rebutted, except where the taxpayer is estopped by his previous actions or statements, in which event the doctrine of estoppel should be proceeded with cautiously and with a careful regard to the circumstances of the case.

Internal Revenue ⊜ 391, 1016

Taxes; Treasury Regulations; construction and operation; generally.

[4] While not statutory, Treasury Regulations have the force and effect of law.

Internal Revenue ⊜ 172

Taxes; basis of property; fair market value; consistency in reporting.

[5] A taxpayer has an equitable responsibility to report transactions which have an impact upon different taxable periods or different taxes in a consistent manner. This "duty of consistency" is an equitable consideration strongly intimated by the requirement of the Internal Revenue Code that fair market value be used to determine the basis of property in estate taxation as well as in income taxation of the recipient of the property.

Internal Revenue ⊜ 302, 1016

Estoppel; grounds for estoppel; consistency of position; taxation.

[6] To establish that a duty of consistency for tax purposes exists, such that a taxpayer is estopped, or quasi-estopped, from changing its position, the taxpayer must have made a representation or reported an item in one year, the Commissioner must have acquiesced or relied on that fact for that year, and the taxpayer must desire to change the representation, previously made, in a later year after the statute of limitations on assessment bars adjustments for the initial year.

Internal Revenue ⊜ 1311

Taxes; income tax; gain or loss on disposition of property; basis of property acquired from decedent; valuation; estoppel.

[7] On the facts disclosed, where taxpayers are either the estate of decedent or trustees of a residual trust created under decedent's will as well as co-administrators of the estate, the taxpayers are estopped, or quasi-estopped, by reason of the lesser value placed on the shares of stock in issue for Federal estate tax purposes, accepted and relied on by the Government, from using a higher value to compute gain on the subsequent redemption of the stock after the statute of limitations has run on the estate tax assessment. Furthermore, while the International Trust created by the wife of decedent, who was appointed executor of her estate, for the benefit of her grandchild, and the estate of decedent are separate legal entities, since the interests of the two entities were closely related and the same individual acted, it is fair and in accord with the spirit

of the law to require the Trust to act in a manner consistent with the estate. The mandate of 26 U.S.C. §§ 1014 and 1031, read together, applies.

Internal Revenue ⟸ 1311

Sidney J. Hess, Jr., attorney of record, for plaintiffs.

Patricia B. Tucker, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *John E. Evans*, of counsel.

Before NICHOLS, KUNZIG and BENNETT, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

This case involves the gains on the redemption of 10,650 shares of International Nikoh Corporation (formerly known as International Rolling Mills Products Corporation and hereinafter referred to as Nikoh) in 1965. The issue is whether the bases on which the gains are computed are the amounts used in the estate tax valuation of two estates through which the stock passed to the taxpayers, or the then fair market values to be newly determined without regard to such amounts. We hold the former in the circumstances of this case.

Plaintiffs are Sidney J. Hess, Jr., William J. Friedman and American National Bank and Trust Co. of Chicago (American National Bank), as successor co-trustees of the Residue Trust for John Jacob Ets Hokin (hereinafter referred to respectively as Residue Trustees for John and Residue Trust for John) and Sidney J. Hess, Jr., and American National Bank as successor co-trustees of the Residue Trust for Lynda Sue Ets Hokin McCracken, John Jacob Ets Hokin, and Lynda Sue Ets Hokin McCracken. Plaintiffs are seeking a refund of federal income taxes paid by (1) the estate of Barney Ets Hokin for the fiscal year ending May 31, 1965 in the amount of $483,794.70; (2) the International Trust for John for the year 1965 in the amount of $86,886.25; and (3) the International Trust for Lynda for the year 1965 in the amount of $57,990.07, plus statutory interest on each amount. We have jurisdiction pursuant to 28 U.S.C. § 1491.

I.

Nikoh manufactured mechanical tubing and electrical mechanical tubing for sale to electrical contractors and manufacturers of such products as bicycles and steel furniture. Nikoh was also involved in steel warehousing.

The Nikoh stock in issue was redeemed from the estate of Barney Ets Hokin and from a certain testamentary trust created by the will of Loraine Ets Hokin.

Loraine Ets Hokin died testate on September 6, 1955. Pursuant to her will, 3470 shares of her Nikoh stock were to be held in a trust referred to as the International Trust for the benefit of her then minor grandchildren, John and Lynda Ets Hokin. The trust was to terminate on December 31, 1970 at which time 60 percent of the assets were to be distributed to John and 40 percent to Lynda. A federal estate tax return was filed on December 18, 1956, valuing the Nikoh stock at $128.81 per share. The Internal Revenue Service (IRS) conducted an audit and as a result thereof, the value of the stock was raised to $200 per share. The estate paid the deficiency and the stock became the corpus of the International Trust for John and Lynda Ets Hokin.

Barney Hokin died testate on June 28, 1962, owning 7,180 shares of Nikoh stock. On the federal income tax return filed on behalf of the estate on September 27, 1963, the Nikoh stock was valued at $98 per share. On the federal estate tax return, the Nikoh stock was valued, as of the Alternate Valuation Date, at $98 per share.

After the death of Barney Hokin, his son, Edwin Hokin, the father of Lynda and John Hokin, filed three suits in the Circuit Court of Cook County, Illinois. One suit named Edward M. Ray, individually and as executor of Barney's estate, John and Lynda Ets Hokin and certain others as defendants and sought to have Barney's will set aside. A second suit against Ray, as executor of the Barney estate, and Nikoh, sought damages for the breach of an alleged contract in connection with Edwin Hokin's sale of Nikoh stock. The third suit named Ray individually, as executor of Barney's estate, and as trustee under Loraine's will, John Hokin and Lynda Hokin as defendants and sought an accounting of the affairs of the trusts set by the will of Loraine Hokin.

Mr. Sidney Hess was retained to represent John and Lynda Ets Hokin in connection with these suits. After extensive negotiations, the various law suits were settled as reflected in court decrees of February 5, 1965 and March 23, 1965. Ray was replaced as trustee of the family trusts. Sidney Hess and American National Bank were appointed trustees for all trusts in which Lynda was primary beneficiary. Hess, American National Bank and William Friedman were designated trustees for all trusts in which John was the primary beneficiary. Pursuant to an "Agreement for Redemption of International Nikoh Corporation Shares," dated January 25, 1965, effective February 5, 1965, the Nikoh stock held by the estate of Barney Ets Hokin and by the International Trust for John and Lynda was redeemed for $367 per share. The interests of John and Lynda were severed, so that the International Trust for John held 60 percent of the corpus previously held by the International Trust for John and Lynda and the International Trust for Lynda held 40 percent of said corpus. Similarly, the residuary estate of Barney Ets Hokin was separated later into two portions of which 60 percent was to be held for the benefit of John and 40 percent was to be held for Lynda.

Ray died unexpectedly on March 14, 1965 and was replaced by Sidney Hess and William Friedman as administrators of the estate of Barney Ets Hokin in April 1965. At that time, the federal estate tax return had already been filed and was undergoing an audit. In June 1965, deficiencies were proposed based on adjustments to entries other than the Nikoh stock, which had been reported at $98 per share. The estate paid the deficiency and no one attempted to correct the $98 per share valuation, although this was after the redemption agreement above mentioned.

On November 15, 1965, Hess, as co-administrator of the Barney Ets Hokin estate, filed the estate's federal income tax return for the fiscal year ending on May 31, 1965. The redemption of the Nikoh stock on February 5, 1965 was reported on this return and the gain thereon computed using the $98 per share value as reported on the taxpayer's federal estate tax return as the cost basis of the stock.

The International Trust from which the remaining shares were redeemed was severed into two parts by court decree of March 23, 1965, as described above. Consequently, although the redemption took place before the severance, the gain was reported by successor trusts known as the International Trust for John and the International Trust for Lynda. The return for the International Trust for John for the year 1965, which was filed by Sidney Hess, William Friedman and the American National Bank, as trustees, used as its basis in the redeemed stock, $200 per share, the amount used to compute Loraine Ets Hokin's federal estate tax. The same $200 per share basis was used computing the gain reported by the International Trust for Lynda on the 1965 return filed by the trustees, Hess and the American National Bank.

The Probate Court approved the First and Final Account of Administrators de bonis non with Will Annexed of the estate of Barney Ets Hokin on May 29, 1967. Among the assets distributed pursuant to this accounting were interests of 60 percent and 40 percent, respectively, to the Residue Trust for John and the Residue Trust for Lynda, in the "claims against the Internal Revenue Service for refund of Federal Estate Tax and Federal Income Taxes."

On June 26, 1967, claims were filed by the trustees of the Residue Trust for John and the Residue Trust for Lynda seeking refund of federal estate taxes paid by the estate of Barney Ets Hokin on several grounds, none of which involved the value of the Nikoh stock redeemed. These claims were partially allowed and the trustees accepted the resulting overassessment in August 1968. No action was taken to increase the value of the Nikoh stock on the estate tax return.

On November 12, 1968, claims for refund were filed by (1) Sidney Hess, William Friedman, and the American National Bank, as trustees of the International Trust for John for the year 1965; and (2) Sidney Hess and the American National Bank as trustees of the International Trust for Lynda for the year 1965. These claims were based on the allegation that the gain reported on the redemption of Nikoh stock from the International Trust, created by the will of Loraine Ets Hokin, was erroneous because the basis of the stock was at least equal to the redemption price of $367 per share rather

than the $200 per share used in computing the federal estate tax. By this time, the statute of limitations had run with respect to the estate tax assessment.

On the same day, claims were filed by (1) Sidney Hess, William Friedman and the American National Bank as trustees of the Residue Trust for John and (2) Sidney Hess and the American National Bank as trustees of the Residue Trust for Lynda. These claims were based on the allegation that the gain reported on the redemption of Nikoh stock from the estate of Barney Ets Hokin was erroneous because the basis of the stock was at least equal to the redemption price of $367 per share rather than $98 per share as reported on the taxpayer's federal estate tax return.

On December 31, 1970, the International Trust for John and the International Trust for Lynda terminated in accordance with the terms of Loraine Ets Hokin's will and the assets of these trusts were thereafter distributed to John and Lynda Ets Hokin respectively. The claims for refund filed by the trustees were among the assets distributed.

On April 16, 1973, waivers of statutory notice of claim disallowances were filed. Thereafter on December 19, 1973, plaintiff filed suit in this court.

II

The case is before the court now on defendant's motion for leave to amend its answer to include the defense of estoppel, filed September 20, 1975, and on defendant's motion for summary judgment, filed August 18, 1975. We consider first defendant's motion for leave to amend its answer.

Defendant, in its motion for summary judgment, argued that plaintiffs should be estopped from arguing that the basis of the Nikoh stock in issue differed from the values used for federal estate tax purposes. However, defendant's original answer, filed March 28, 1974, did not contain the defense of estoppel, which under this court's Rule 37(b) must be affirmatively pleaded. Defendant contends that plaintiff's counsel have been on notice that defendant intended to assert the issue of estoppel since June 1974 and that therefore, plaintiffs will not be prejudiced by an amendment of the pleading at this time. Plaintiff opposes the mo-

tion alleging that defendant was "grossly delinquent" in its failure to raise the defense at an earlier date.

This court's Rule 38(h) provides that if a party does not affirmatively plead estoppel in its answer, the defense is waived. However, Rule 39(a) allows the pleadings to be amended by leave of court "which shall be freely given when justice so requires." Rule 39(b) allows for amendment of the pleadings to conform to the evidence at any time, even after trial.

Rule 39(a) and 39(b) should be liberally construed. The Supreme Court has stated that "* * * [i]n the absence of any apparent or declared reason—such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc.—the leave sought should, as the rules required, be 'freely given.' * * *" *Foman* v. *Davis*, 371 U.S. 178, 182 (1962) (discussing Fed. R. Civ. P. 15(a) which is identical to our Rule 39(a)).

Plaintiffs contend that there has been undue delay and that they will be prejudiced by defendant's amendment at this point. Neither argument withstands close scrutiny. Mere delay is insufficient to bar amendment of the pleadings and plaintiff has not demonstrated that it has been or will be prejudiced, other than the fact that it incurred costs in discovery proceedings with respect to the value of the stock. Plaintiffs have not been precluded from presenting their case. Plaintiffs knew at some time prior to oral argument that estoppel was an issue and were able to brief and argue the point. Justice requires that defendants be granted leave to amend, pursuant to Rule 39(a). Moreover, we could also grant defendant's motion based on Rule 39(b). As the court said in *Erickson* v. *United States*, 159 Ct. Cl. 202, 210, 309 F. 2d 760, 764 (1962), "* * * here the course of proceedings was such that it is just and proper to consider the pleadings amended (under our Rule [39(b)], 'Amendments To Conform to the Evidence') to state the defense of estoppel * * *." In *Erickson*, plaintiff's counsel was aware of the defense of estoppel at trial. He did not introduce evidence to counteract this defense which he would have done had estoppel been pleaded, but

he did inform the court what the evidence would have been, and for purposes of the opinion, it was taken as if proven. Thus although the defendant in *Erickson* did not affirmatively plead estoppel in its answer, the court, after trial, nevertheless considered the affirmative defense of equitable estoppel. Similarly, the evidence before the court here strongly indicates an estoppel and therefore mandates that defendant be allowed to amend its answer to conform to the evidence in accordance with Rule 39(b) to permit justice to be done. Plaintiffs admit that the value used to determine estate tax liability is different from the value they seek to use to compute the gain on the redemption of the stock. There is no dispute as to the facts relied on to raise the issue of estoppel and of course we could not find any disputed facts at this time.

Accordingly, defendant's motion for leave to amend its answer is granted. Although we have allowed the motion on the strength of Rules 39 (a) and (b), we could have granted the motion without consideration of these rules. The defense to plaintiffs' petition is based in large part on the Internal Revenue Code and Treasury Regulations. As such it is not merely an equitable defense, such as the word "estoppel" normally denotes as stated in *Erickson*, *supra*, but more in the nature of a legal defense. As indicated below, it is sometimes called "quasi-estoppel." Failure to raise such an issue in the answer does not constitute waiver of the defense.

III

We now turn to defendant's motion for summary judgment. The issue in this case is whether the estate must use the value of stock as reported on its federal estate tax as its basis in computing gain on the subsequent redemption of the stock, and, similarly, whether a testamentary trust must use the value of stock as finally determined for the purpose of the federal estate tax as its basis in computing gain on the subsequent redemption of the stock. Defendant bases its argument on theories of estoppel, quasi-estoppel, and the "duty of consistency," and posits that the estate of Barney Ets Hokin and the International Trusts created by the will of Loraine Ets Hokin should be estopped from using as the

basis of the stock any value other than that used by the respective estates in computing their federal estate tax. Plaintiffs, however, urge that they should be allowed to prove that the stock in question was erroneously undervalued for estate tax purposes. Plaintiffs contend that the Nikoh stock was worth at least $367 per share as of the two dates used for valuation of the stock by the estates.

As a general rule, the basis of property in the hands of a person acquiring the property from a decedent is the fair market value of the property at the date of the decedent's death or at the alternate valuation date if used. 26 U.S.C. § 1014(a). This basis, as adjusted, is used if the property is later sold, exchanged, or, as in the present case, redeemed, in order to determine gain or loss. 26 U.S.C. §§ 1001, 1011. The fair market value of the property at the time of the decedent's death or at the alternate valuation date is also the amount required to be reported on the taxpayer's federal estate tax return. 26 U.S.C. §§ 2031, 2032. The identity of the two values in the congressional mind is clearly indicated by the fact that the election by the decedent's estate to use the alternate valuation date binds the subsequent income tax payer. This would be often meaningless if the value figure chosen did not bind him also.

The success of an estate in getting through IRS audit a low valuation of property may turn into a Pyrrhic victory in the event of subsequent income taxation. This is a matter practitioners in the field are well aware of and it tends to minimize disputes as to the valuation of estates, where assets other than listed securities are involved, and especially with real property. It furthers the concept of self-assessment. However, a rule that the estate tax valuation must always be the basis for the subsequent income tax, might be fair, and within the congressional contemplation, but it is too simple to stand against the trends that ever operate to maximize complexity in our tax structures. Should there ever be a plain and simple rule, something is sure to happen to it. So here. We do not wish, however, to use our powers to enlarge the exceptions already extant, and further complicate the rule.

It is too late in the day to rely exclusively on a literal reading of the statute. Treasury Regulation 1.1014–3 provides

that the value of property as of the date of decedent's death as appraised for the purpose of the federal estate tax or the alternate value as appraised for such purpose "shall be deemed to be its fair market value," and so provided at the date of the transactions here involved. While not statutory, Treasury Regulations do have the force and effect of law. The Internal Revenue Service explained further in Rev. Rul. 54–97, 1954–1 CUM. BULL. 113 that "* * * [e]xcept where the taxpayer is estopped by his previous actions or statements, such value is not conclusive but is a presumptive value which may be rebutted by clear and convincing evidence." And finally, this court, in *Ford* v. *United States*, 149 Ct. Cl. 558, 276 F. 2d 17 (1960), stated that a then applicable Treasury Regulation, which corresponds to Treas. Reg. 1.1014–1, was intended to make the appraised value prima facie evidence of actual value. We noted in *Ford* that the regulation and the doctrines of estoppel should be "* * * proceeded with cautiously, and with a careful regard to the circumstances of the case." At 566, 276 F. 2d at 21. The court did not say that estoppel could never be applied, but only that the facts of the *Ford* case did not warrant such an application.

After giving "careful regard to the circumstances of the case," we hold for defendant. Courts have long recognized that a taxpayer has an equitable responsibility to report transactions which have an impact upon different taxable periods or different taxes in a consistent manner. *R. H. Stearns Co.* v. *United States*, 291 U.S. 54 (1934). The Congress recognized this duty with respect to income taxes when it enacted section 3801 of the 1939 Internal Revenue Code, now 26 U.S.C. §§ 1311–15, relating to the correction of errors when a taxpayer or the Commissioner has taken an inconsistent position in a later year after the statute of limitations had expired. This provision does not apply here, but this so-called "duty of consistency" is also an equitable consideration strongly intimated by the Code's requirement that fair market value be used to determine the basis of property in the taxation of the estate and also in the income taxation of the recipient of the property.

Three elements are necessary to establish that a duty of consistency exists, such that a party is estopped, or quasi-estopped, from changing its position. First, the taxpayer must have made a representation or reported an item for tax purposes in one year; second, the Commissioner must have acquiesced or relied on that fact for that year; and third, the taxpayer must desire to change the representation, previously made, in a later year after the statute of limitations on assessment bars adjustment for the initial years. *Beltzer* v. *United States*, 495 F. 2d 211, 213 (8th Cir. 1974). The term "quasi-estoppel" is used approvingly in that case, which involves a situation much like the one here. See also other cases cited therein.

Plaintiff contends that the duty of consistency is not applicable because defendant did not rely on the valuation of the stock as set forth in the Barney and Loraine Ets Hokin estate tax returns. Plaintiff seems to argue that since defendant conducted an audit, plaintiffs' representations as to value were ignored. In the Barney estate, the Government accepted the value of the stock in question as reported in the estate tax return as a partial tax base. It relied on the estate's initial valuation and later acceptance of any change due to the audit. Plaintiffs did not seek to raise the value of the stock until after the statute of limitations had run on the estate tax assessment, thereby causing the defendant to rely, perhaps to its detriment, on the agreed valuations. With respect to the Barney estate, Mr. Hess and Mr. Friedman, who were appointed co-administrators in 1965, moreover did not correct the $98 per share value on the estate tax return after the redemption agreement at $367, nor did they seek to raise that figure when they filed a federal income tax return for the estate. In the Loraine estate tax return, the $200 figure was the Government agent's figure but the estate representatives acquiesced in it and cannot but have had some input in establishing it, if only by claiming a still lower figure initially.

Plaintiffs rely heavily on *Ford* v. *United States*, *supra*, to support their position that it should not be estopped from proving the actual value of the stock in issue. This court did not find the necessary basis for estoppel in *Ford* after examining the facts of that case. The facts of the instant case

are distinguishable and the result need not be, and is not, the same as in *Ford*.

In *Ford*, the plaintiffs sold stock which they had received from their father's estate and reported the gain on their own personal income tax returns. In computing gain, they used as their basis in the stock a larger figure than that used by their father's estate for federal estate tax purposes. The court held that plaintiffs were not estopped from proving actual value as of the date of their father's death because they had not taken part in the representation made in the federal estate tax return. Thus *Ford* does not aid us in determining whether the Barney estate is estopped from proving a higher value for purposes of determining gain on the redemption of the stock. Here, there is a direct change of position by a single taxpayer, the estate of Barney Ets Hokin. Moreover, the individuals who are trustees of the Residual Trust created under the will of Barney Ets Hokin were also co-administrators of the estate. They filed claims for refund of federal estate tax on grounds other than the value of the Nikoh stock and accepted the valuation of the stock at $98 per share.

Plaintiffs assert that John and Lynda Ets Hokin are the real parties in this matter as they are the ultimate beneficiaries of the Barney estate. Presumably, plaintiffs think that this argument brings the case within the scope of *Ford*. However, we do not agree, since neither is the taxpayer here, nor filed the returns in issue, and therefore their interests are only derivative.

The remaining question is whether the International Trust must use the same basis in computing its gain as the estate which created it. The estate and the trust are separate legal entities; however, the mandate of 26 U.S.C. §§ 1014 and 2031, read together, does apply. The interests of the two entities being very closely related, and the same individual having acted, we think it only fair and in accord with the spirit of law, to require the trust to act in a manner consistent with the estate. *Beltzer*, *supra*, involved taxpayers who were not the estate which made the original representation. That court distinguishes *Ford* as involving per-

sons who were minors when the estate tax return was filed and had nothing to do with it.

Plaintiffs strenuously maintain that summary judgment is inappropriate because there are facts in dispute, necessitating trial. We have not relied on any facts except undisputed ones, and the facts plaintiffs would like to prove would not change the result.

Accordingly, defendant's motion for leave to amend its answer is granted. Defendant's motion for summary judgment is granted. The petition is dismissed.

KUNZIG, *Judge*, dissenting:

In good conscience, I must dissent. This court has been treated to a lengthy oral argument of facts by plaintiffs, followed by an even more vehement discussion of confusing, conflicting and even opposite facts by defendant. Clearly, the present posture of this case calls for a trial to resolve relevant facts in two crucial areas, once and for all.

First, the majority's decision permits defendant to amend its answer some two years after the original answer was filed.[1] The amendment allows defendant to plead the defense of estoppel, quasi-estoppel or duty of consistency. The conclusion of the majority is premised upon its opinion that amendment should be granted "in the interests of justice" under Ct. Cl. Rule 39. Normally, I would agree with the court. Leave to amend should be freely granted where one party presents a valid claim or defense and the other party is not prejudiced by the amendment. *Foman* v. *Davis*, 371 U.S. 178, 182 (1962). However, I believe that defendant must be

[1] Even more serious is the majority's dicta to the effect that defendant need not have entered a motion to amend its answer in order to rely on the "duty of consistency" defense. The court bottoms this idea on its notion that the duty is more in the nature of a *legal defense* rather than an *equitable* one. However, the court's characterization ignores the dictates of Ct. Cl. Rule 37 and the philosophy of notice pleading. Rule 37(b) requires that affirmative defenses or matters constituting an avoidance be specifically set forth in the pleadings. The "duty of consistency" is clearly in the nature of an avoidance. As such it must be set forth affirmatively in defendant's answer, or waived under Ct. Cl. Rule 38(h). Otherwise defendant could "trap" unwary plaintiffs by failure to put them on notice that they will have to resist the "duty of continuity" avoidance.

compelled to do justice in order to reap its benefits. In the instant case plaintiffs allege that defendant's conduct has caused them to undertake expensive discovery procedures which could have been avoided had defendant submitted a proper answer. Accordingly, I would, at least, condition defendant's leave to amend on repayment of any additional costs caused by its erroneous course of conduct. A trial to determine such amounts is necessary.

Second, the majority finds plaintiffs bound to use the estate tax values for computation of gain on subsequent stock redemptions under a "duty of consistency." The majority distinguishes *Ford* v. *United States*, 149 Ct. Cl. 558, 276 F. 2d 17 (1960), on the basis that the plaintiffs in that case were sufficiently removed from earlier representations as to alleviate any estoppel or duty of consistency. The majority in the present action, *without the benefit of a trial on the operative facts*, finds that the plaintiffs are either identical or so closely related to those who made earlier representations as to be bound by the earlier declarations. The court would apparently give only lip service to the admonition of *Ford* that:

> [A]pplication of the doctrine of estoppel and *related doctrines with an equitable flavor*, * * * be proceeded with cautiously, and with careful regard to the circumstances of the case.

Although the majority states that it has given such careful consideration to the circumstances of this case, the detailed factual disputes which highlighted oral argument have apparently been resolved in favor of the Government. This is especially crucial with regard to the International Trust in which different taxpayers are being held to the "duty of consistency" without key findings as to the closeness of their relationship or without other crucial determinations (important in *Ford*) as to actions taken by the IRS at the time of the estate tax filings. Again, I would remand the case to the trial division for resolution of relevant facts and the applicability of the *Ford* case to the present action.

I, therefore, dissent from the decision of the majority and would remand this entire matter to the trial judge for appropriate action not inconsistent with the above.

Syllabus

538 F. 2d 875

VELMA L. CRONE, ET AL. v. THE UNITED STATES

[No. 293-74. Decided July 9, 1976]*

ON DEFENDANT'S AND PLAINTIFFS' MOTIONS FOR SUMMARY JUDGMENT

Military pay; Missing Persons Act of 1942; pay and allowance claims; standing to sue; class action request; validity of death determinations; retroactive application of prior decision; trial de novo.— Plaintiffs are the parents or wives of seven American servicemen who were placed in missing-in-action (MIA) status during the Vietnam War and who, since May 1970, have been the subjects of determinations of death pursuant to the Missing Persons Act of 1942, as amended, although their remains have never been recovered. Plaintiffs seek voidance of the death determinations, restoration of the servicemen involved to MIA status, and back pay and allowances for the period running from the date of each respective determination of death. Plaintiff-parents request certification of a general class comprising all next-of-kin of the MIA's who were the subjects of death determinations, and sue not on their own behalf but on behalf of the MIAs whom they represent as "next friends." Plaintiff-wives request certification of a sub-class comprising those members of the general class who, as dependents of MIAs, seek to recover back pay and allowances which ceased upon determinations of death. Plaintiffs contend that the subject determinations of death, because concededly made without affording prior notice and hearing to adversely affected parties and because allegedly made arbitrarily and capriciously, in the absence of standards and adequate evidence, should be held void *ab initio*. It is *held* (1) that the "next friend" plaintiffs lack standing to maintain this action either on their own behalf or on behalf of the absent servicemen; (2) that so long as they are entitled to receive allotments as provided by the Missing Persons Act, the dependent wives have standing to prove in this action that their allotments were unlawfully discontinued; (3) that, because this is a suit wherein individual questions of fact clearly predominate over the common legal issues, it should not be maintained as a class action; (4) that the *McDonald* v. *McLucas* decision, 371 F. Supp. 831 (1974), will not be applied retroactively by this court to declare all prior determinations of death void *ab initio;* and (5) that plaintiff-wives, Heideman and Sullivan, are entitled to a de novo trial on the validity of the death determinations under the standards of review articulated in decisions previously handed down by this court. Defendant's motion for summary judgment is granted and the petition is dismissed as to all plaintiffs except the plaintiff-wives; plaintiffs' motion for summary judgment is denied;

*See order, post at 748, on plaintiffs' motion for rehearing.

Syllabus

and the claims of the plaintiff-wives are remanded to the Trial Division for further proceedings.

Military pay; Missing Persons Act of 1942; pay and allowances entitlement.

[1] Under 37 U.S.C. §§ 552(b), 555(b)(1) the entitlement of a member of a uniformed service who is missing in action to pay and allowances, and of his dependents to appropriate allotments therefrom, terminates on the date when such member becomes the subject of either an official report or presumptive finding of death under Sec. 556(b).

Armed Services ⇐ 23.3(1)

Pleading and practice; parties; standing to sue or be sued.

[2] Fundamental to this court's jurisprudence is the principle that, in every suit, there must be a real party in interest to whose present, personal benefit a money judgment may run. The term "incompetent persons" in Rule 61(c) cannot be construed to include missing persons. This is so because any judgment running to the benefit of a missing person is, of necessity, speculative, hypothetical, and contingent upon such person's possible survival and reappearance.

Courts ⇐ 462

Military pay; Missing Persons Act of 1942; "next friend" plaintiffs; standing to sue.

[3] While 37 U.S.C. § 552(a)(1) provides that a serviceman who is in a missing status is entitled to have credited to his account the same pay and allowances to which he was entitled at the beginning of the missing-status period or to which he may thereafter become entitled, an "account" is not a real party in interest for purposes of Court of Claims Rule 61. Under Sec. 552 the rights of formerly missing servicemen or prisoners of war to recover, upon their return, the pay and allowances expressly reserved for them under the Missing Persons Act, are not extinguished by erroneous determinations of death. For this court to accord those present plaintiffs who are parents of missing servicemen the right to represent the servicemen and protect their interests as "next friends" would, in effect, provide a remedy without a right and without a proper party to enforce it.

Armed Services ⇐ 23.5
Courts ⇐ 462

Statutes; construction and operation; legislative intent; generally.

[4] In statutory construction, unless the language is compelling, it is best to avoid interpretations no one can believe the Congress could have intended.

Statutes ⇐ 181(1)

Syllabus

Court of Claims jurisdiction; declaratory judgments.

[5] The court is without authority to grant a money judgment under the Missing Persons Act to persons other than dependents of servicemen missing in action or the servicemen themselves when and if they return. Relief requested by persons seeking to vindicate the rights of the servicemen as "next friends" is of a declaratory and equitable nature.

Courts ⟸ 449(1)

Pleading and practice; parties; standing to sue.

[6] Since 37 U.S.C. § 553 entitles dependents of missing servicemen to allotments of pay and allowances for so long as their spouses are carried in missing-in-action status, such plaintiffs have standing to litigate in this court an action to resolve whether or not such allotments were unlawfully discontinued as a result of putatively unlawful determinations of death, provided such allotments were due and owing in the first instance.

Courts ⟸ 462

Pleading and practice; summary judgment; when appropriate.

[7] Ordinarily an unsupported allegation challenging documents attached to the opposing party's motion for summary judgment, is insufficient to create an issue of fact which must be resolved by a trial. However, since discovery by plaintiff was deferred on defendant's motion and inasmuch as the facts surrounding the alleged death of plaintiff's husband are exclusively in the possession of the defendant, the court will not grant summary judgment but will remand the claim to the Trial Division to afford the plaintiff an opportunity to engage in discovery of facts which may resolve the issue of her standing to sue and her right to recover.

Courts ⟸ 470

Pleading and practice; class actions; Court of Claims jurisdiction and practice.

[8] Rule 23 of the Federal Rules of Civil Procedure is not binding on this court, and until the court's own needs and the capacity of class action machinery to meet those needs may be better understood, the court will handle class actions on a case-by-case basis; however, the fact that the court regards the "requirements" of Rule 23 as merely "criteria" does not diminish their persuasiveness in appropriate cases.

Courts ⟸ 462

Pleading and practice; class actions; Court of Claims jurisdiction and practice.

[9] Where, in the present suit, the validity of the death determinations of certain servicemen is ultimately a factual question which must be resolved through trial on an individual basis, and where the common legal issue does not predominate and override the sep-

arate factual issues, the court will not entertain the suit as a class action.

Courts ⇐ 462

Court of Claims jurisdiction; treaty claims.

[10] The court lacks jurisdiction to consider plaintiffs' claim that their rights have been abridged under the Vietnam Peace Treaty. 28 U.S.C. § 1502.

Courts ⇐ 449(1)

Courts; nonretroactive application of decisions.

[11] Where the three-judge court, in deciding *McDonald* v. *McLucas*, 371 F. Supp. 831 (1974), explicitly refrained from making any pronouncements concerning the rights or interests of persons already adversely affected by prior determinations of death (and consequent discontinuance of allotments), this court will not apply retroactively the *McDonald* holding, insofar as it struck down the statutory scheme of 37 U.S.C. §§ 555, 556, as violative of due process in failing to provide dependents of missing persons with reasonable notice and an opportunity to be heard at appropriate missing-in-action status review proceedings, where such application would render all prior determinations of death void *ab initio*.

Courts ⇐ 100(1)

Military pay; Missing Persons Act of 1942; administrative determinations of death; finality of determination.

[12] Administrative determinations of death under Sec. 9 of the Missing Persons Act of 1942 are final and nonreviewable unless it is shown that such determinations were arbitrary or capricious.

Armed Services ⇐ 23.3(1)

Dermot G. Foley, attorney of record, for plaintiffs. *Kaplin, Kilsheimer & Foley*, *R. Alan Stotsenburg*, *Michael Hausfeld*, and *Jerry S. Cohen*, of counsel.

Susan M. Linden, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Rose E. Adewale-Mendes*, *Frank A. Luna*, *David P. Schulingkamp*, and *Richard Stearns*, of counsel.

Before COWEN, *Chief Judge*, DAVIS, and KUNZIG, *Judges*.

COWEN, *Chief Judge*, delivered the opinion of the court:

This suit challenges the validity of certain "official reports of death" and presumptive "findings of death" made by the Secretaries of the Army, Navy and Air Force, or their designees, pursuant to the Missing Persons Act, ch. 166, 56 Stat.

143 (1942), *as amended*, 37 U.S.C. §§ 551–57. Plaintiffs are the parents and spouses of seven American servicemen who were placed in missing-in-action (MIA) status during the Vietnam War and who, since May 1970, have been the subjects of such determinations of death, although their remains have never been recovered.

We have jurisdiction of this suit pursuant to 28 U.S.C. § 1491. Plaintiffs claim monetary relief under 37 U.S.C. §§ 552 and 553. Section 552(a) provides that

> [a] member of a uniformed service who is on active duty * * *, and who is in a missing status, is * * * for the period he is in that status, entitled to receive or have credited to his account the same pay and allowances * * * to which he was entitled at the beginning of that period or may thereafter become entitled. * * *

Continuance of full pay and allowances is required for so long as the serviceman "can reasonably be presumed to be living" and is maintained in MIA status. 37 U.S.C. §§ 552(e), 555(a)(1). Section 553 authorizes the Secretaries of the military departments, or their designees, as appropriate, to initiate, continue or increase allotments of such pay and allowances for the support and benefit of the dependents or designated beneficiaries of MIAs.

Entitlement of an MIA to pay and allowances, and of his dependents to appropriate allotments therefrom, terminates on the date when such MIA becomes the subject of either an official report or presumptive finding of death under Section 556(b). 37 U.S.C. §§ 552(b), 555(b)(1). During the period May 1970 to June 1973, the pay and allowances of each of the MIAs involved in this action were discontinued pursuant to official determinations of death. During this same period, allotments of such pay and allowances to two of the plaintiffs herein, Patricia Heideman and Susan Sullivan, who are or were the dependents of MIAs, were similarly discontinued.

Plaintiffs seek to maintain this suit as a class action on behalf of a general class and a sub-class. Plaintiffs Velma L. and Paul E. Crone, Marjorie J. Pickett, Ivan and Betty Wiley, Adeline B. and Norman P. Westwood, Sr., and Mildred L. and Raymond J. Lodge, as parents of the former MIAs, request certification of a general class comprising all

"next-of-kin of the MIA's who were the subjects of * * * determinations of death, [suing] not on their own behalf but on behalf of the MIA's whom they represent as next friends." Plaintiffs Susan Sullivan and Patricia Heideman, as wives of the former MIAs, request certification of a sub-class comprising "those members of the general class who, as dependents * * * and/or the designated beneficiaries of their respective MIA's, seek recovery of monetary damages which they personally sustained as a result of such * * * determinations of death." Plaintiffs seek voidance of the death determinations, restoration of the servicemen involved to MIA status, and back pay and allowances for the period running from the date of each respective determination of death.[1]

Three principal questions are presented by the parties' cross-motions for summary judgment: (1) whether those plaintiffs who purport to sue solely as "next friends" of the former MIAs have standing to maintain this action; (2) whether those plaintiffs with standing may maintain their suit as a class action; and (3) whether the determinations of death, because concededly made without affording prior notice and hearing to adversely affected parties and because allegedly made arbitrarily and capriciously, in the absence of standards and adequate evidence, should be held void *ab initio*. We answer all three questions in the negative. Accordingly, we deny plaintiffs' cross-motion and grant defendant's motion for summary judgment as to all plaintiffs except Patricia Heideman and Susan Sullivan, whose claims are remanded to the Trial Division for further proceedings consistent with this opinion.

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[1] Plaintiffs contend, citing *American Pipe & Constr. Co.* v. *Utah*, 414 U.S. 538 (1974) and *Eisen* v. *Carlyle & Jacquelin*, 417 U.S. 156, 176 n. 13 (1974), that all claims based on determinations of death subsequent to July 19, 1967, should not be time-barred, since plaintiffs were unnamed members of the general class of MIA next-of-kin which sought certification to challenge the same statutory scheme in *McDonald* v. *McLucas*, 371 F. Supp. 837 (S.D.N.Y. 1973) (three-judge court convened), notwithstanding the *McDonald* court's denial of class certification and elimination of the instant plaintiffs from that suit for failure to be properly represented by a named party. 371 F. Supp. 831, 833 (S.D.N.Y.), *aff'd mem.*, 419 U.S. 987 (1974). Since we deny plaintiffs' request for class status in the instant case, and since none of the instant claims (all of which arose since May 1970) would otherwise be barred by our statute of limitations, 28 U.S.C. § 2501, we need not reach this question.

I

Facts[2]

1. *Plaintiffs Velma L. Crone and Paul E. Crone*

Plaintiffs Velma and Paul Crone are the parents of Specialist (SP4) Donald E. Crone, who was placed in MIA status on February 15, 1971, when the CH–47 "Chinook" helicopter in which he was flying as crew chief on a combat resupply mission crashed into enemy-held territory in Laos. In connection with an investigation, conducted pursuant to Army Regulations (AR) 600–10, Chap. 3, para. 31b, of the circumstances surrounding the crash, several sworn statements were filed.

Lieutenant Colonel (Lt. Col.) William N. Peachey, who was piloting an aircraft in the vicinity of the CH–47 and witnessed the crash, stated:

> At that time the sling load, carried by the CH–47, burst into flames. Seconds later the aircraft burst into flames and exploded. The aircraft exploded at an approximate altitude of 2500 feet above the ground. I flew over the wreckage at approximately 100 feet and could see no survivors. I was forced to depart the area because of enemy fire. In my opinion there could have been no survivors.

No ground search was conducted of the crash site. On March 5, 1971, a Missing Persons Board of Inquiry recommended that the status of SP4 Crone, and of the five other members of the helicopter crew, be changed from MIA to killed-in-action. On March 30, 1971, Division Headquarters, U.S. Army, Vietnam, concurred in the recommendation and, on April 10, 1971, the recommendation was approved by Order of the Secretary of the Army. During the period February 15, 1971 to April 10, 1971, the date evidence of

[2] The facts which follow are primarily drawn from the Government's briefs and submissions, including official military records. Plaintiffs do not dispute these facts per se, but contend that, in the absence of discovery, they have been unable to secure additional material evidence still in the Government's possession. We find the facts as here set forth sufficient for purposes of our instant disposition of this case. However, in view of our decision to remand the claims of plaintiffs Patricia Heideman and Susan Sullivan to the Trial Division of this court for a de novo trial on the merits of their claims, plaintiffs will have ample opportunity at that time to introduce such new and additional evidence as may be relevant to that proceeding.

death was officially received by the Army, SP4 Crone was carried in MIA status and his pay and allowances were credited to his account pursuant to 37 U.S.C. § 552. The remains of SP4 Crone were not recovered.

2. *Plaintiff Marjorie J. Pickett*

Plaintiff Marjorie Pickett is the mother of Corporal (Corp.) Robert E. Grantham, who was placed in MIA status on March 8, 1971, when the aircraft in which he was flying as a crew member crashed in Vietnam. In connection with an investigation, conducted pursuant to AR 600–10, several sworn statements were filed.

Warrant Officer James E. Davey, who witnessed the crash from a nearby aircraft, stated:

> Upon impact the LOH exploded into flames. Once I reached the area I did two tight orbits over the burning LOH looking for any personnel that might have survived the crash. Not seeing anyone I moved my aircraft in a few feet away from the wreckage and hovered. I instructed my crew to look for any survivors. Concerned about being a good target. I took off and did one more orbit around the area and approached it again. I hovered a few feet above the aircraft for approximately 45 seconds. No one in my crew could spot any bodies or any survivors. The aircraft had completely come apart and was in small burning pieces. While I was hovering the AK–1G said that I was taking fire and I departed the area.

The remains of Corp. Grantham were not recovered. From March 8, 1971, the date of the crash, to May 14, 1971, when evidence of death and the recommendation of the board of inquiry were received by the Army, Corp. Grantham was carried in MIA status and pay and allowances were credited to his account pursuant to 37 U.S.C. § 552.

3. *Plaintiffs Ivan Wiley and Betty Wiley*

Plaintiffs Ivan and Betty Wiley are the parents of SP4 Richard Denis Wiley, who was placed in MIA status on June 12, 1972, following the crash of his aircraft in Vietnam. In connection with an investigation of the circumstances surrounding his MIA status, pursuant to AR 600–10, several sworn statements were filed.

Warrant Officer Thomas E. Martin, who survived the crash, stated:

> The aircraft took .30 caliber antiaircraft fire. * * * [It] turned 180° upon hitting trees, tumbled backwards several times. I could get out. SP4 Wiley's legs were caught under the roof after the aircraft came to rest on its right side. [The aircraft] exploded causing SP4 Wiley to be killed. While on the ground we took heavy small arms fire. I tried to get SP4 Wiley out of the aircraft. * * *

The remains of SP4 Wiley were not recovered. During the period June 12, 1972, the date of the crash, to August 26, 1972, when evidence of death and the recommendation of the board of inquiry were received by the Army (which then issued a report of death under 37 U.S.C. § 556(b)), SP4 Wiley was carried in MIA status and pay and allowances were credited to his account pursuant to 37 U.S.C. § 552.

4. *Plaintiffs Adeline B. and Norman P. Westwood, Sr.*

Plaintiffs Adeline and Norman Westwood, Sr., are the parents of Lieutenant (Lt.) Norman Philip Westwood, Jr., who was placed in MIA status[3] on May 17, 1970, when the aircraft he was piloting on a night bombing mission crashed at sea shortly after its catapult launch from the USS CORAL SEA. The Navy received and approved a report of death on May 18, 1970, from the Commanding Officer, USS CORAL SEA, which stated:

> (2) Search for missing pilot of F4–B, Lt. Norman Philip Westwood, Jr., * * * was terminated at 0900 H, 18 May 70. Crash site was vividly marked and definitely established by fuel fire on surface of the water. * * * Area was thoroughly searched using ships' motor whale boat and search and rescue helicopters. Results were negative.

[3] Defendant contends that "[s]ince Lt. Westwood's death was determined by the local commander within hours of his loss, he never entered a missing status under 37 U.S.C. § 551 *et seq.*, and no determination of death as envisioned by that statute was even made by the Navy." Plaintiffs, however, argue that Lt. Westwood was placed in MIA status *prior* to issuance of any official report of death since, *inter alia*, a telegram was sent to plaintiffs Westwood on May 18, 1970, the day following the crash, which states: "* * * your son Lt. Norman Philip Westwood, Jr., * * * was reported missing on 17 May 1970, at sea as the result of an aircraft accident." Since we conclude, in Part II of this opinion, that plaintiffs Westwood lack standing to maintain this action, it is unnecessary for us to resolve this question here.

(3) It is thus considered that the pilot was lost at sea and died in the line of duty as a result of the aircraft accident. His body was not recovered.

5. *Plaintiff Patricia Heideman*

Plaintiff Heideman is the wife of Master Sergeant (M. Sgt.) Thomas E. Heideman, who was allegedly placed in MIA status on October 24, 1970, when the CH–3 "Chinook" helicopter in which he was flying as flight engineer crashed during a mission over Laos. Within 24 hours of the crash, an official report of death was received and approved by the Air Force. M. Sgt. Heideman's remains were not recovered.

6. *Plaintiffs Mildred L. and Raymond J. Lodge*

Plaintiffs Mildred and Raymond Lodge are the parents of Major Robert A. Lodge, who was placed in MIA status on May 10, 1972, when the F–4 aircraft he commanded was hit by enemy fire and crashed during a combat patrol mission near Hanoi, North Vietnam. Major Lodge's remains were not recovered. The official report of death, approved by the Air Force pursuant to 37 U.S.C. § 556(b) on May 9, 1973, states in pertinent part as follows:

> 1.d. * * * Captain Locher ejected at approximately 4,000 feet. Upon his ejection, his helmet rotated over his eyes and he was unable to see for five or ten seconds. When he was able to straighten his helmet, he noticed an air-to-air missile explode about one mile behind him. When he looked down on the ground, he saw their aircraft burning. He looked for Major Lodge's parachute but could not find it. During his period of evasion he found no evidence which would help to establish the fate of his aircraft commander. * * *
>
> e. Examination of available records and reports pertaining to the status of Major Lodge discloses no information that he has been seen or heard from since the beginning of his missing in action status. There has been no accounting of him from the North Vietnamese government or its allies, and no information pertaining to him has been obtained from any other source.

7. *Plaintiff Susan Sullivan*

Plaintiff Sullivan is the wife of Lt. Col. Farrell J. Sullivan, who was placed in MIA status on June 27, 1972, when the F–4 aircraft he commanded was hit by a surface-to-air missile and crashed during a strike mission over Hanoi, North

Vietnam. Lt. Col. Sullivan's remains were not recovered. The official report of death, approved by the Air Force on or about June 22, 1973, pursuant to 37 U.S.C. § 556(b), states in pertinent part that:

> 2.a. * * * Captain Francis had the feeling that the aircraft was being engulfed in flames and elected to eject about three seconds after it was hit. Col. Sullivan did not say anything during this time. While descending in his parachute, he looked all around but did not observe another parachute. He heard nothing about Col. Sullivan from other POWs during his captivity. Approximately five months following his capture, a North Vietnamese guard advised him that his pilot had died in the wreckage. * * * It is [Captain Francis'] personal opinion that Col. Sullivan did not survive the aircraft shoot down.

Although not specifically alleged by plaintiffs, it is assumed, for purposes of these cross-motions, that during the period June 27, 1972, the date of the crash and placement of Lt. Col. Sullivan in MIA status, to June 22, 1973, the date of the official determination of death, Lt. Col. Sullivan's pay and allowances were credited to his account pursuant to 37 U.S.C. § 552, and regular allotments therefrom were paid to his wife, plaintiff Susan Sullivan, pursuant to 37 U.S.C. § 553.

II

Standing

A. *The "Next Friend" Plaintiffs*

Of the eleven named plaintiffs in this action, all but two (plaintiffs Heideman and Sullivan) are parents of servicemen who were the subjects of the challenged determinations of death. These plaintiffs do not purport to characterize themselves as "dependents" of MIAs, as defined by 37 U.S.C. § 551, by alleging that they are "dependent parents," dependents designated in official records, or persons determined to be dependent by the Secretary concerned or his designee. *See Howell* v. *United States*, 141 Ct. Cl. 699, 702, 159 F. Supp. 597, 599 (1958); *Mills* v. *United States*, 124 Ct. Cl. 782, 784 (1953). Nor do they otherwise claim any personal interest in or entitlement to the allotments of pay and

allowances provided for the support of such dependents under 37 U.S.C. § 553.

Rather, these nine plaintiffs purport to sue "not to protect their own interests but [to protect] the interests of those absent MIA's" whom they seek to represent solely as "next friends." In support of this novel position, the "next friend" plaintiffs assert that the "next friend" concept is an ancient one; that, as such, they are merely "nominees," while the protected parties are the real parties in interest;[4] and that "it is the need which the protected person has for representation, rather than the fortuitous nature of the proceeding before the Court, that gives rise to 'next friend' standing."

To this conceptual brickwork plaintiffs then add the mortar of legal precedent. They cite *United States ex rel. Sero* v. *Preiser*, 506 F. 2d 1115, 1126 n.8 (2d Cir. 1974), *cert. denied*, 421 U.S. 921 (1975),[5] and *United States ex rel. Bryant* v. *Houston*, 273 F. 915 (2d Cir. 1921), for the proposition that "next friends" may file habeas corpus petitions on behalf of incarcerated minors, and a host of state cases, for the proposition that "next friends" may litigate the interests of infants and incompetent persons, respectively. Review of these cases here would serve no useful purpose. The principle sought to

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[4] It may be noted that if plaintiffs, as they allege, are not the real parties in interest, then they have failed to meet the pleading requirements of our Rule 61(a), which provides:

"Every action shall be prosecuted in the name of the real party in interest; but an executor, administrator, guardian, trustee of an express trust, receiver, trustee in bankruptcy, or other representative appointed by a judicial tribunal, or a party authorized by statute, may sue in his own name without joining with him the party for whose benefit the action is brought."

Since plaintiffs do not allege that they have been either "appointed by a judicial tribunal" or "authorized by statute" to maintain this suit, they should properly have joined as named parties those absent servicemen who allegedly *are* the real parties in interest: *e.g.*, "Donald E. Crone, a missing person, by his parents and next friends, Velma L. Crone and Paul E. Crone." *See Fahrner* v. *Gentzsch*, 355 F. Supp. 349, 350–53 (E.D. Pa. 1972); 3A Moore, Federal Practice, ¶17.26, at 908 n.21 (2d ed. 1974). This defect in the pleadings, at least in its formal aspect, is of course not fatal. Our Rule 64 provides for adding or dropping parties on such terms as are just. However, such amendments would avail plaintiffs nothing because of our decision that all but plaintiffs Heideman and Sullivan lack standing to sue.

[5] It should be noted that in *Sero*, as distinguished from the instant case, the "next friend" plaintiffs were suing *on their own behalf*, as well as on behalf of others, and that the court, moreover, construed the relevant *statute* to authorize such "next friend" representation. There are, of course, even more significant distinctions.

be invoked by their recitation is fully recognized in Rule 61(c) of the rules of this court, which provides:

> Whenever an infant or incompetent person has a representative, such as a general guardian, committee, conservator, or other like fiduciary, the representative may sue or defend on behalf of the infant or incompetent person. If an infant or incompetent person does not have a duly appointed representative, he may sue by his *next friend or by a guardian ad litem.* [Emphasis added.]

See Capoeman v. *United States*, 194 Ct. Cl. 664, 670, 440 F. 2d 1002, 1004 (1971).

The obvious, albeit unarticulated, flaw in plaintiffs' argument is the assumed equation of infants and incompetent persons on the one hand with missing or absent persons on the other. Plaintiffs, in effect, would have us construe the term "incompetent persons" in our Rule 61(c) to include missing persons. This is an untenable construction. Fundamental to this court's jurisprudence is the principle that, in every suit, there must be a real party in interest to whose present, personal benefit a money judgment may run. Missing persons do not and cannot meet this requirement. This is so because any judgment running to the benefit of a missing person is, of necessity, speculative, hypothetical, and contingent upon such person's possible survival and reappearance.

Plaintiffs attempt to circumvent this obstacle by resort to the language of 37 U.S.C. § 552(a)(1) which provides, in pertinent part, that a serviceman "who is in a missing status, is * * * for the period he is in that status, entitled to receive *or have credited to his account* the same pay and allowances * * * to which he was entitled at the beginning of that period or may thereafter become entitled." [Emphasis added.] The short answer to this argument is that an "account" is not a real party in interest. A slightly longer answer is that this court has repeatedly recognized the rights of formerly missing servicemen or prisoners of war to recover, *upon their return*, the pay and allowances expressly preserved for them under the Missing Persons Act. 37 U.S.C. § 552; *see Espartero* v. *United States*, 152 Ct. Cl. 789, 791–92 (1961); *Campbell* v. *United States*, 137 Ct. Cl. 742, 746, 149

F. Supp. 199, 202 (1957); *Mills* v. *United States*, 124 Ct. Cl. 782, 784 (1953). Those rights are not extinguished by an erroneous determination of death. 37 U.S.C. § 556(d). No more is due under that Act. To infer more would be, in effect, to provide a remedy without a right and without a proper party to enforce it.

Nor can plaintiffs derive any support from the legislative history of the Missing Persons Act. "[T]he primary purpose of [that Act] was to alleviate financial hardship suffered by the dependents of servicemen reported as missing." *Bell* v. *United States*, 366 U.S. 393, 408 (1961); *McDonald* v. *McLucas*, 371 F. Supp. 831, 833 (S.D.N.Y. 1974) (three-judge court). We can find in that history no evidence, nor have plaintiffs referred us to any, of Congressional intent that persons other than dependents of MIAs, or the MIAs themselves when and if they return, be permitted to assert entitlement to the protection and benefits which that Act confers.

The principle is familiar that, "[i]n statutory construction, unless the language is compelling * * * it is well to avoid interpretations no one can believe the Congress could have intended." *Blaha* v. *United States*, 206 Ct. Cl. 183, 192, 511 F. 2d 1165, 1168 (1975); *Anderson* v. *United States*, 203 Ct. Cl. 412, 420, 490 F. 2d 921, 925, *cert. denied*, 419 U.S. 827 (1974). Here, neither the language of this otherwise precise and detailed statute, nor the historic circumstances which occasioned its enactment, compel—or even permit—an interpretation consistent with plaintiffs' position. In asking this court to grant a money judgment in the absence, possibly permanent, of those very parties whose rights are here sought to be vindicated and to whose benefit alone such judgment could run, plaintiffs, in effect, request relief of a declaratory and equitable nature which this court is without authority or jurisdiction to grant. *See Testan* v. *United States*, 424 U.S. 392 (1976); *United States* v. *King*, 395 U.S. 1, 5 (1969); *Austin* v. *United States*, 206 Ct. Cl. 719, 723, *cert. denied*, 423 U.S. 911 (1975). For the foregoing reasons, we hold that the next friend plaintiffs lack standing to maintain this action either on their own behalf or on behalf of the absent servicemen.

B. *The "Dependent" Plaintiffs*

It is undisputed that the remaining plaintiffs, Patricia Heideman and Susan Sullivan, are or were dependents of missing servicemen within the meaning of 37 U.S.C. § 551. As such, the statute clearly entitles them to allotments of pay and allowances for so long as their husbands are carried in MIA status. 37 U.S.C. § 553; *see Mills* v. *United States*, 124 Ct. Cl. 782 (1953). Each of the "dependent" plaintiffs thus has standing to litigate this action, in an effort to prove that such allotments were unlawfully discontinued (as a result of the putatively unlawful determinations of death), *provided* that such allotments were due and owing in the first instance.

Defendant contends that plaintiff Heideman lacks standing because she fails to meet this last proviso. Since M. Sgt. Heideman, according to defendant, was never placed in missing status under 37 U.S.C. § 552, but was the subject of an immediate determination of death, the Missing Persons Act is not involved, and plaintiff Heideman was never entitled to nor ever received the allotments provided thereunder. Thus, defendant argues that plaintiff Heideman lacks standing to challenge the validity of those determinations inasmuch as she has not been deprived of any statutorily or constitutionally protected right, and has not otherwise sustained any judicially cognizable injury in fact.

In response to defendant's contentions, plaintiffs state that:

> We intend to establish that in 1970 Sgt. Heideman became a casualty on a clandestine mission. The helicopter was carrying Thai troops when it crashed. Everyone was rescued except Sgt. Heideman and one other crew member. No one saw either of the missing men die. It was approximately 24 hours before personnel returned to the scene to strip the guns off the helicopter and to search for bodies and for missing persons. The body of the other crewman was found at the site, but there was no sign of Sgt. Heideman. Thus, as to him, a classic MIA situation was presented and under Service Regulations, Sgt. Heideman must have been reported missing. * * *

Plaintiffs have not supported this narrative of events with an affidavit or with documentary evidence challenging the documents attached to defendant's motion for summary judgment. Normally, we would hold that this unsupported narrative is not sufficient to create an issue of fact which must be resolved by a trial. However, plaintiffs correctly assert that their initial efforts to obtain discovery were suspended on defendant's motion pending the court's ruling on legal issues raised by the cross motions for summary judgment.

Thus, we are confronted with a difficult situation in which the issue of plaintiff Heideman's standing to sue is intertwined with the possibility of her right to recover if she can establish her version of the facts. Under all the circumstances, we conclude that this question should be resolved by denying defendant's motion and remanding the claim to the Trial Division, where plaintiff will have an opportunity to engage in discovery of facts which may entitle her to recover. We are persuaded to this view, in part, because none of the facts regarding the fate of M. Sgt. Heideman are in plaintiff's possession with the exception of such information as has been furnished to her by defendant. *See Schoenbaum* v. *Firstbrook*, 405 F. 2d 215, 218 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969).

III

The Class Action Request

Since we have concluded that only plaintiffs Heideman and Sullivan have standing, we need not consider plaintiffs' arguments concerning the general class of next friend/next-of-kin members. The sub-class of which plaintiffs here seek certification comprises "over 1,500" dependents and/or designated beneficiaries of MIAs who have, presumably like plaintiffs Heideman and Sullivan, "personally sustained property losses as a result of determinations of death." In support of their request, plaintiffs allege that this sub-class falls within the category of class actions properly maintainable under Rule 23(b)(3) of the Federal Rules of Civil Procedure, and otherwise satisfies the threshold prerequisites set forth in Rule 23(a).

At the outset, it may be reiterated that Rule 23 is not binding on this court; that we have not adopted a rule equivalent to Rule 23 and that we have not yet promulgated any general rule governing class actions. Instead, we decided in *Quinault Allottees Ass'n* v. *United States*, 197 Ct. Cl. 134, 140, 453 F. 2d 1272, 1276 (1972), and reaffirmed that decision in *Clincher* v. *United States*, 205 Ct. Cl. 8, 11, 499 F. 2d 1250, 1252 (1974), *cert. denied*, 420 U.S. 991 (1975), to handle class actions on a case-by-case basis until such time as this court's own needs, and the capacity of class action machinery to meet those needs, may be better understood. We did not decide, however, to proceed *in vacuo*, without interest in the experience of other Federal courts, or without responsiveness, where warranted, to the criteria of Rule 23. That, for the present, we regard the "requirements" of Rule 23 as merely "criteria" does not diminish their persuasiveness in appropriate cases. *See Quinault Allottees Ass'n* v. *United States*, *supra*, 197 Ct. Cl. at 140–41, 453 F. 2d at 1276.

In the instant case, we have no difficulty in concluding that, under the most liberal of rules or criteria, this suit should not be maintained as a class action. This is so because, as we hold in Part IV of this opinion, the validity of the death determinations is ultimately a factual question which must be resolved, through trial, on an individual basis. This is not a case in which the "common legal issue [here, the constitutionality of 37 U.S.C. §§ 555 and 556] is a predominant one, overriding any separate factual issues affecting the individual members" of the purported class. *Quinault Allottees Ass'n* v. *United States*, *supra*, 197 Ct. Cl. at 140, 453 F. 2d at 1276 (criterion (iii)); *see Banks* v. *Travelers Ins. Co.*, 60 F.R.D. 158, 163 (E.D. Pa. 1973) (Rule 23(b)(3)).

There are other reasons for denying class action status in this case. Since, absent these obstacles, our result would necessarily be the same, we need only briefly mention them here. First, we simply cannot conclude, despite plaintiffs' vigorous assurances, that "the claims of the present plaintiffs are typical of the claims of the class" or that "the current plaintiffs will fairly and adequately protect the interests of the class without conflict. * * *" *Quinault Allottees Ass'n* v. *United States*, *supra*, 197 Ct. Cl. at 140, 141, 453 F. 2d at 1276

(criteria (iv) and (vii)); *see Phillips* v. *Klassen*, 502 F. 2d 362, 367 (D.C. Cir.), *cert. denied*, 419 U.S. 996 (1974) (Rule 23(a) (3) and (4)). As the three-judge court recognized in *McDonald* v. *McLucas*, 371 F. Supp. 831, 836 (S.D.N.Y.), *aff'd mem.*, 419 U.S. 987 (1974):

> With the repatriation of American prisoners of war which followed the signing of the Paris Peace Accord on January 28, 1973, an emotional breach has occurred among the families of missing servicemen who did not return home. On the one hand, we find families like the plaintiffs who understandably still hope for the return of their loved ones, and who actively contest any change in a missing status finding. On the other hand, there are those who have accepted the apparent fate of death as to their relatives, and who desperately want the services to make immediate determinations of death so that emotionally and actually they might begin their lives anew.
>
> The anguish of each of these opposing groups has been intense and is reflected in communications to the court.

A second factor militating against class action treatment of the instant case is the fact that, as in *Clincher* v. *United States*, *supra*, 205 Ct. Cl. at 12, 499 F. 2d at 1253, "test case" resolution of the legal issues common to members of the "dependent" class will provide adequate relief by permitting potential plaintiffs to proceed directly to trial.

Third, since each case must turn on a factual question, there is little likelihood, in contrast to *Quinault*, of the kind of "inconsistent or varying adjudications" which might impair the ability of those similarly situated to protect their interests. *Quinault Allottees Ass'n* v. *United States*, *supra*, 197 Ct. Cl. at 141, 453 F. 2d at 1276 (criterion (viii)); *see Banks* v. *Travelers Ins. Co.*, *supra*, 60 F.R.D. at 163 (Rule 23(b)(1)(B)).

Lastly, this does not appear to be a case, as was *Quinault*, where individual claims are "so small that it is doubtful that they would be [otherwise] pursued." *Quinault Allottees Ass'n* v. *United States*, *supra*, 197 Ct. Cl. at 140–41, 453 F. 2d at 1276 (criterion (vi)); *see Free World Foreign Cars, Inc.* v. *Alfa Romeo*, 55 F.R.D. 26, 29 (S.D.N.Y. 1972) (Rule 23(b)(3)). In sum, because this is a suit wherein individual

questions of fact clearly predominate over the common legal issues, the request for class action status is denied.

IV

The Validity of the Death Determinations

A. *The Statutory Scheme*

Plaintiffs challenge the constitutionality of Sections 555 and 556 of Title 37 of the United States Code, under which the Secretary of each military department, or his designee, can [6] where warranted, change the status of a member of the Armed Forces who is officially carried in a missing status to that of killed-in-action.

Briefly, the statute authorizes two alternative means by which the Secretary or his designee may make a determination of death. The first, designated an "official report of death," may be made upon the receipt of "information" which "establishes conclusively the death of a member of a uniformed service." 37 U.S.C. § 556(b). The second, designated a "finding of death," may be made when the Secretary considers that "the information received, or a lapse of time without information establishes a reasonable presumption that a member in a missing status is dead." *Id.* § 556(b).

Section 555 provides for Secretarial review of the status of any missing serviceman no later than 12 months after his placement in missing status. If, upon completion of such review, the serviceman "can reasonably be presumed to be living," the Secretary may then direct continuance of his missing status. *Id.* § 555(a)(1). Otherwise, a "finding of death" may be made, based on the serviceman's absence for a year and the lack of any conclusive information as to his whereabouts. *Id.* § 555(a)(2).

At the time the contested determinations were made, the various services, in practice, had established informal missing persons boards or councils of inquiry to conduct review

[6] In 1974, immediately following issuance of the declaratory judgment holding the above statutory procedure unconstitutional, and the permanent injunction prohibiting its continued application in cases where a hearing is requested after notice, each of the military departments either amended its regulations or promulgated new ones in order to satisfy the minimum due process standards required by the decision in *McDonald* v. *McLucas*, *supra*.

of a serviceman's status under 37 U.S.C. § 555(a), on the basis of evidence and reports, if any, received from the field. The Secretary or his designee then reviewed the recommendation of the board and issued the final determination. *McDonald* v. *McLucas*, *supra*, 371 F. Supp. at 833.

Plaintiffs challenge this statutory scheme, both on its face and as applied, on two basic grounds:[7] (1) that it failed (at the time the determinations were made) to provide dependents of MIAs, whose allotments could thereby be terminated, with reasonable notice of, and an opportunity to be heard at, appropriate status review proceedings [the notice and hearing ground]; and (2) that it sets forth no standards or criteria, with the result that determinations which were made thereunder are necessarily arbitrary, capricious and unsupported by substantial evidence [the evidentiary ground].

B. *The McDonald Decision*

In *McDonald* v. *McLucas*, the three-judge court, addressing similar challenges to the identical statutory scheme involved herein, declared that scheme unconstitutional as violative of the Due Process Clause of the Fifth Amendment, and permanently enjoined any future determinations of death thereunder except in accordance with the procedural safeguards (i.e., prior notice and a hearing on request) announced in the decision. 371 F. Supp. at 836.

Although defendant is concededly bound by the *McDonald* decision, it argues that (1) both the notice and hearing and the evidentiary grounds advanced by plaintiffs were specifically decided by the *McDonald* court, which found only the first of these meritorious; and (2) the *McDonald* holding should be applied only prospectively.

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[7] Plaintiffs' petition actually sets forth five separate counts of constitutional challenges, each containing multiple subcounts. In the interest of clarity, and because we find it unnecessary to reach plaintiffs' constitutional challenges as the basis for decision in this case, we simplify their recitation here. For like reasons, we hereafter abbreviate those challenges as "the notice and hearing ground" and "the evidentiary ground" as described above. Plaintiffs also contend that their rights have been abridged under the Vietnam Peace Treaty, 24 T.I.A.S. No. 7542 (Jan. 27, 1973). We lack jurisdiction to consider this claim. 28 U.S.C. § 1502; *see Hughes Aircraft Co.* v. *United States*, 209 Ct. Cl. 446, 467–473, 534 F. 2d 889, 902–906 (1976).

Plaintiffs counter that (1) since the *McDonald* court was not presented with the claims of parties already injured by prior determinations of death,[8] it did not (nor had it need to) specifically address or decide the evidentiary ground; and (2) the *McDonald* holding, insofar as it struck down the statutory scheme at issue on the notice and hearing ground alone, should be applied retroactively.

As to the first question, we agree with plaintiffs that the *McDonald* court neither decided nor addressed the evidentiary ground here advanced for the second time. The initial District Court opinion in the case, in issuing a temporary restraining order and convening the three-judge court, dismissed from the complaint for want of proper parties to espouse it, one of the counts which contained a substantial portion of the evidentiary ground:

> Count three claims that the defendants have acted, and are continuing to act, arbitrarily and capriciously in making findings of death. Whatever remedy may exist to examine such a charge, it is one which is clearly not available to these plaintiffs who represent MIAs as to whom findings of death have not as yet been made.

371 F. Supp. 837, 840 (S.D.N.Y. 1973). As for the remaining portions of the evidentiary ground, even cursory reading of the three-judge court's opinion should disclose that it turns solely upon the abrogation of procedural due process (i.e., the notice and hearing ground). Such a reading should likewise reveal the following statement:

> In view of the court's disposition of the procedural due process attack against Sections 555 and 556, *the additional grounds urged for declaring the sections unconstitutional need not be considered.*

371 F. Supp. at 837. [Emphasis added.]

As to the second question, we view plaintiffs' suggestion that *McDonald* be applied retroactively so as to render all prior determinations of death void *ab initio*, as being entirely without merit. We have previously indicated that the *Mc-*

[8] As the three-judge court itself clearly stated:

"[N]one of the named plaintiffs are proper representatives of the group of military personnel who have previously been declared dead under Sections 555 and 556. They could only represent those 'designated next-of-kin' of members who are still missing." 371 F. Supp. at 838.

Donald court carefully and explicitly refrained from making any pronouncements concerning the rights of interests of persons already adversely affected by prior determinations of death (and consequent discontinuance of allotments), for the reason that none of the named plaintiffs in that action was a proper representative of such persons. 371 F. Supp. at 833; *see* note 8, *supra*.[9] We have also previously discussed, in Part III of this opinion, the *McDonald* court's recognition of the breach which existed between those still hoping for the return of the missing servicemen despite the determinations of death, and those desirous of finality so as to begin their lives anew. Indeed, in an effort to "accommodate the interests of both groups of families without sacrificing the constitutional rights of any individual," the *McDonald* court limited even the prospective effect of its holding, by providing that "any change in procedures which the defendants must make in order to conform with this decision need only be applied to those next-of-kin who demand it after notice." 371 F. Supp. at 836.

We are not aware of a single precedent which would support, under these circumstances, retroactive application of the *McDonald* decision in the manner which plaintiffs urge. There is a corpus of precedent which leads to a contrary conclusion. As the Supreme Court stated in *Chevron Oil Co.* v. *Huson*, 404 U.S. 97, 107 (1971):

> '[W]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the "injustice or hardship" by a holding of nonretroactivity.'

See Cipriano v. *City of Houma*, 395 U.S. 701 (1969); *Allen* v. *State Bd. of Elections*, 393 U.S. 544 (1969); *Hanover Shoe, Inc.* v. *United Shoe Mach. Corp.*, 392 U.S. 481 (1968); *Stovall* v. *Denno*, 388 U.S. 293, 297 (1967); *Simpson* v. *Union Oil Co.*, 377 U.S. 13 (1964); *England* v. *State Bd. of Medical Examiners*, 375 U.S. 411 (1964); *Chicot County Drainage Dist.* v. *Baxter State Bank*, 308 U.S. 371 (1940); *Brown* v.

[9] Plaintiffs in fact conceded this much in contending that the *McDonald* holding was limited to the notice and hearing issue. In this regard, their arguments are inherently self-contradictory.

United States, 508 F. 2d 618 (3d Cir. 1974), *cert. denied*, 422 U.S. 1027 (1975). Therefore, we decline to hold that all previous determinations of death were void *ab initio*.

With respect to plaintiffs' second ground for contesting the subject determinations of death, that they were effected arbitrarily and capriciously, and without substantial evidence, we dismiss out of hand defendant's suggestion that the determinations were expressly intended, and consistently held by this court, to be nonreviewable and conclusive. Defendant's precedents directly rebut this contention. In *Espartero* v. *United States*, 152 Ct. Cl. 789, 791–92 (1961), the court stated:

> We have held that Section 9 [of the Missing Persons Act] prevents this court from reviewing a determination under this Act *unless it is shown that such determination was arbitrary or capricious.* [Emphasis added.]

To similar effect are *Alpuerto* v. *United States*, 152 Ct. Cl. 270, 271 (1961), and *Moreno* v. *United States*, 118 Ct. Cl. 30, 43–44, 93 F. Supp. 607, 610 (1950), *cert. denied*, 342 U.S. 814 (1951).

No discourse is required here to perceive the difference between those administrative determinations which are nonreviewable and those which are reviewable by the application of the arbitrary and capricious standard. It is well-established that under this standard, we may review a determination to see whether it is supported by substantial evidence. Nor, in military pay cases, is this review necessarily limited to the administrative record. In appropriate situations, we have decided that a claimant is entitled as a matter of right to a de novo trial on the disputed issues of fact. *See Bray* v. *United States*, 207 Ct. Cl. 60, 73–74, 515 F. 2d 1383, 1390–91 (1975); *Montilla* v. *United States*, 198 Ct. Cl. 48, 57, 457 F. 2d 978, 983 (1972); *Brown* v. *United States*, 184 Ct. Cl. 501, 503–19, 396 F. 2d 989, 991–1000 (1968). This is such a case, and, therefore, we hold that plaintiffs Heideman and Sullivan are entitled to a de novo trial on the validity of the subject death determinations under the standards of review articulated in the cases just cited.

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Conclusion

Accordingly, it is ordered that defendant's motion for summary judgment is granted and the petition is dismissed as to all plaintiffs except Patricia Heideman and Susan Sullivan; that plaintiffs' motion for summary judgment is denied; and that the claims of Patricia Heideman and Susan Sullivan are remanded to the Trial Division for further proceedings in accordance with this opinion.

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537 F. 2d 466

STATE OF TEXAS v. THE UNITED STATES

[No. 374–73. Decided July 9, 1976]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Federal Disaster Act; Government obligations.—Nominal plaintiff, the State of Texas, on behalf of two counties, claims it is entitled to certain sums in Federal Disaster Act funds in addition to those approved by the Office of Emergency Planning (OEP) for eligible disaster work performed in the counties declared major disaster areas as a result of Hurricane Beulah. The two counties entered into contracts with a private contractor for emergency work contingent upon availability of Federal funds. Plaintiff and the Government entered into a Federal Disaster Assistance Agreement providing for Federal funds in accordance with the Act, implementing regulations and as directed by the President. It is *held* that OEP, having provided plaintiff with all of the funds authorized by the President for Federal assistance, has completely fulfilled its obligations to provide such assistance under the terms of the parties' agreement. The Presidential action and the corresponding action of OEP of providing the authorized amounts of Federal assistance to plaintiff fully and reasonably complies with the requirements of the Act and the agreement. Plaintiff, having already received $10,000,000 in Federal assistance, cannot recover additional funds by way of a breach of contract action. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

Federal Disaster Act; Federal assistance agreements; Government obligations thereunder.

[1] A Federal Disaster Assistance Agreement specifying that Federal assistance will be made available in accordance with various specified laws, Executive Orders and regulations obligates the Fed-

Syllabus

eral Government to provide only such assistance as called for by the agreement.

United States ⇐ 82

Claims against the United States; generally.

[2] It has long been the rule that when an officer or agency of the United States does all it agreed to do, and all it was authorized to undertake, a plaintiff can ask no more of the Government.

United States ⇐ 93

Contracts; breach of contract; express terms.

[3] In suing for a breach of contract, a plaintiff must rely on the express terms of the contract and cannot import into the instrument terms outside of those expressly contained therein.

Contracts ⇐ 326

Federal Disaster Act; Federal assistance agreements; Office of Emergency Planning circulars; scope of.

[4] The circulars issued by the Office of Emergency Planning under the Federal Disaster Act program merely provide instructions and rules to State and local officials in applying for assistance under the Act and do not of themselves obligate the Government to reimburse applicants all of the costs of private contractors who meet the eligibility criteria of the circulars.

United States ⇐ 82

Federal Disaster Act; Federal assistance agreements; refusal to reimburse full costs; arbitrary and capricious action; what constitutes.

[5] Assuming, *arguendo*, that the disaster relief funding estimates in the Federal Damage Survey Reports were inaccurate and that the Office of Emergency Planning deliberately revised and diluted an independent report which criticized the original estimates, it was not arbitrary and capricious for the Government to refuse to reimburse the full costs of the private contractors where the uncontested facts indicate that all the Federal Disaster Act called for, all the parties' agreement provided for, and all the agency obligated itself to do was to provide Federal assistance up to the monetary limits authorized by the President within the authority conferred upon him by the Act.

United States ⇐ 82

Federal Disaster Act; construction and operation; judicial enforcement.

[6] Judicial enforcement of consensual and statutory limitations on the extent of the Government's fiscal liability in an undertaking is the customary rather than the extraordinary in the field of Federal contracting. In the instant case, upholding the action of the Office of Emergency Planning in limiting Federal assitance to the amount of funds authorized by the President in anticipation of major dis-

asters across the country is a reasonable measure to assure that funds will be available to render Federal assistance in such event.

United States ⇐ 82

Federal Disaster Act; construction and operation; legislative intent.

[7] Congress enacted the Federal Disaster Act with full knowledge that funding would never be sufficient to provide complete relief in times of major disasters or to make everyone whole. The purpose was to provide an orderly and continuing means of assistance by the Federal Government to States and local governments in carrying out their responsibilities to alleviate suffering and damage.

United States ⇐ 82

Robert H. Koehler, attorney of record, for plaintiff. *Patton, Boggs & Blow; John L. Hill* and *Elizabeth Levatino*, of counsel.

Thomas W. Petersen, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DURFEE, *Senior Judge*, NICHOLS, and BENNETT, *Judges*.

DURFEE, *Senior Judge*, delivered the opinion of the court:

By motion for summary judgment the Government asks the court to grant it judgment dismissing plaintiff's petition asserting that in refusing to grant plaintiff's requests for additional disaster relief funds under the Federal Disaster Act defendant breached its Disaster Assistance Agreement with plaintiff or alternatively acted arbitrarily and capriciously.

Responding by cross-motion for summary judgment nominal plaintiff, the State of Texas, seeks judgment on behalf of two of its counties on the above asserted claims of wrongful Government action in the amount of $656,245. Defendant's motion is granted and plaintff's motion denied for the reasons set forth below.

On September 20, 1967 Hurricane Beulah struck the southeastern portion of the State of Texas devastating a twenty-nine-county area of the State including Cameron and Willacy Counties. In the aftermath of the disaster the Office of Emergency Planning (OEP) administratively located in the Executive Office of the President established

field offices in the disaster area and Regional OEP officials, together with various other Federal authorities, met with State and local Government representatives to discuss Federal disaster relief assistance to the hurricane-stricken area. As a result of these meetings Federal officials advised the State and local authorities that the southeastern portion of Texas would probably be declared a major disaster area by the President pursuant to the Federal Disaster Act (42 U.S.C. 1855–1855g)[1] which would thereby activate the disaster relief provisions of the Act. Federal officials further advised the State and local representatives that they could undertake necessary emergency work pending the Presidential disaster declaration by contracting with qualified private contractors.

On September 28, 1967 the President declared a 29-county area of Texas, including Cameron and Willacy Counties, a major disaster area pursuant to the Federal Disaster Act. On September 27, 1967 and October 9, 1967 Cameron and Willacy Counties respectively entered into contracts with a private contractor for debris removal and other related disaster relief work. These contracts were contingent upon the availability of Federal funds. On October 5, 1967 OEP and the State of Texas executed a Disaster Assistance Agreement. The initial agreement authorized OEP's expenditure of not more than 2.5 million dollars for use in furnishing disaster assistance. A November 1967 supplement to the agreement provided an additional 7.5 million dollars in disaster assistance funds. A June 1970 supplement to the agreement authorized the use of such additional funds as the OEP Director found necessary for Federal disaster assistance within the limits of funds available from Congressional appropriations for such purposes and authorized by the President. The record indicates that OEP has provided plaintiff with all of the ten million dollars authorized by the President for Federal assistance to the State and is devoid of any Presidential authorization to OEP to expend Federal disaster assistance funds in excess of that amount.

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[1] In 1970 Congress repealed the Federal Disaster Act of 1950 [42 U.S.C. 1855–1855g] and replaced it with an expanded Act now found at 42 U.S.C. § 4401, *et seq.* (1970).

Following the execution of the Federal-State Disaster Assistance Agreement both Cameron and Willacy Counties submitted project applications for Federal disaster relief financial assistance. The applications after State approval were submitted to OEP for approval. Project applications describe the estimated amount of necessary disaster relief work and the estimated cost thereof. Cameron County submitted its project application on November 13, 1967 requesting $1,461,040.62 in financial disaster assistance. Of this amount the State approved $621,786 and OEP concurred in the State's approved amount of Cameron County's project application. On December 6, 1967 both the State and OEP approved Willacy County's submitted project application in the amount of $258,248. In both cases the amounts approved by the State and awarded by OEP were the amounts set forth in the Federal Damage Survey Reports on the hurricane damage to the two counties prepared by Federal inspection teams following Hurricane Beulah's devastation.

Subsequently both counties submitted supplemental project applications requesting additional disaster relief funds in excess of those approved on submission of their initial project applications. Cameron County requested an additional $840,252 and Willacy County sought an additional $443,695. After consideration of these supplemental applications the OEP Regional Director in June 1969 awarded Cameron and Willacy Counties additional disaster relief funds in the respective amounts of $32,574 and $14,191. With the award of these additional funds Cameron County received $730,553 of its requested amount of $1,538,231 and Willacy County received $429,504 out of a requested funding of $615,839.

Dissatisfied with the OEP Regional Director's partial disallowance of the funding requested in the two counties' project applications, the State of Texas appealed to the OEP National Director for full allowance of the sums requested by the counties, and approved by the State for disaster relief work. The State sought $807,678 on behalf of Cameron County and $186,335 on behalf of Willacy County. Incident to the State's two appeals OEP commissioned a private engineering report by Bovay Engineers, Inc. to assist and advise OEP in evaluation of the State's claims. The drafts of

the Bovay report reached conclusions critical of OEP's accuracy in estimating the cost and amount of disaster relief work. OEP-suggested revisions of the draft Bovay reports, subsequently incorporated into the final report, diluted some of the report's criticism of OEP's underestimating of actual damage relief work in the two Texas counties.

Following receipt of the final Bovay report the OEP staff prepared its own report to the OEP Director reviewing the two counties' claims and concluding that the claims should be partially allowed. On July 7, 1970 the OEP Director notified the State that based on a review and re-evaluation of all information provided by the OEP staff and Bovay Engineers, Inc. that he had approved additional disaster relief funding in the amounts of $321,352 for Cameron County and $127,525 for Willacy County. The Director's decision raised OEP-approved disaster relief funding to $1,051,905 for Cameron County and $557,029 for Willacy County. Contending that there were apparent deficiencies in OEP computations of the sums approved for disaster work in the two counties, the State requested the OEP Director to approve the additional amounts requested by the two counties, *i.e.*, $486,326 and $58,810 respectively. This the OEP Director declined to do and confirmed his July 7, 1970 decision as to the amounts approved for funding of disaster relief work in the two counties.

After an unsuccessful appeal to the Comptroller General this action followed with the State contending that OEP had either breached its Disaster Assistance Agreement with the State and/or acted arbitrarily and capriciously in denying the full amounts of OEP disaster relief funding requested by Cameron and Willacy Counties in their project applications.

At the outset both parties devote considerable argument as to whether their Disaster Assistance Agreement is, as plaintiff contends, a contract, or as defendant asserts, not "a binding contract in the traditional sense." In our view defendant's valid execution of a document, which it prepared and titled "Federal-State Disaster Assistance Agreement," specifying that "Federal assistance will be made available in accordance with [various specified laws, Executive Orders and regulations]" obligates defendant to provide such as-

sistance as called for by the parties' Agreement.[2] *See State of Arizona* v. *United States*, 204 Ct. Cl. 171, 494 F. 2d 1285 (1974). After consideration of the various other arguments presented by the parties, the court views the question of whether defendant performed its obligations according to the parties' Agreement as the dispositive issue in this case. We hold that it has.

By the Federal Disaster Act Congress authorized Federal agencies to effectuate the intent of the Act [3] by providing disaster assistance as directed by the President.[4] In turn the President by Executive Order [5] authorized the Director of OEP to exercise the authority conferred on the President by the Act. This delegation of authority included the direction, upon the determination that a major disaster had occurred, to provide Federal assistance to the devastated State from funds allocated by the President to the OEP Director for disaster relief assistance in the devastated State.[6] The Federal assistance was to be provided from funds allocated by the President to the OEP Director to furnish such assistance to State and local Governments in a major disaster on the basis of an agreement jointly executed by the State's Governor and the OEP Director. As the basis for the provision

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[2] The Comptroller General has ruled that executed Disaster Assistance Agreements impose enforceable obligations on both parties to the agreement. Comp. Gen. Decision B–167790 (January 15, 1973). See also 42 Comp. Gen. 289 (1962).

[3] 42 U.S.C. § 1855 states the Congressional intent behind the Federal Disaster Act as follows:

"1855. DECLARATION OF CONGRESSIONAL INTENT.—It is the intent of Congress to provide an orderly and continuing means of assistance by the Federal Government to States and local governments in carrying out their responsibilities to alleviate suffering and damage resulting from major disasters, to repair essential public facilities in major disasters, and to foster the development of such State and local organizations and plans to cope with major disasters as may be necessary." [See 42 U.S.C. § 4401(b) (1970)].

[4] 42 U.S.C. § 1855b provides:

"In any major disaster, Federal agencies are authorized when directed by the President to provide assistance * * * (d) by performing on public or private lands protective and other work essential for the preservation of life and property, clearing debris and wreckage, making emergency repairs to and temporary replacements of public facilities of States and local governments damaged or destroyed in such major disasters, * * * *and making contributions to States and local governments for purposes stated in this subdivision.* * * *." [Emphasis added].

[5] Executive Order No. 10427, January 16, 1953, as amended by Executive Order No. 10737, October 29, 1957.

[6] Executive Order No. 10737, October 29, 1957, as amended by Executive Order No. 10773, July 1, 1958.

of Federal Disaster Assistance to States such agreements were to contain State assurances that reasonable amounts of State and/or local Governments' funds would be expended to alleviate damage caused by the disaster and such other terms and conditions that the OEP Director would require consistent with the provisions of the Act. By promulgated regulations [7] and OEP Circulars supplied to States at the time of a major disaster, the OEP Director prescribed the terms and conditions under which Federal assistance would be made available to the State. Plaintiff raises no challenge that any of the regulations or OEP Circular rules promulgated by the OEP Director are invalid. Among the terms insisted upon by the OEP Director as a condition to Federal assistance was the provision that only such funds as the President authorized would be available for transfer under the Federal–State agreements.[8]

While plaintiff relies on several provisions of the parties' Agreement which it contends obligates defendant to reimburse plaintiff all of the costs regardless of amount it incurred to private contractors in performing disaster relief work, plaintiff seemingly ignores the provision of the parties' Agreement that:

> 5. The Director of the Office of Emergency Preparedness will allocate such amounts as he finds necessary for Federal disaster assistance for use in connection with this major disaster, within the limits of funds available from Congressional appropriations for such purposes *and authorized by the President.* [Emphasis added].

This provision of the parties' Agreement expressly limits the amount of Federal assistance which defendant will provide to plaintiff under the parties' Disaster Assistance Agreement to that amount authorized by the President regardless of the costs plaintiff incurs for disaster relief work. The provision makes no reference to plaintiff's costs but emphatically states that OEP's obligation under the parties' Agreement is to provide Federal disaster assistance within the limits of funds authorized by the President. OEP, having provided plaintiff with all of the funds authorized by the President for Federal assistance to the State, it has completely fulfilled its

[7] 32 C.F.R. § 1710 (1967).
[8] 32 C.F.R. § 1710.9 (1967).

obligation to provide Federal assistance under the terms of the parties' Agreement, and plaintiff cannot recover additional disaster assistance funds from defendant by way of a breach of contract action. It has long been the rule that when an officer or agency of defendant does all it agreed to do, and all it was authorized to undertake, a plaintiff can ask no more of the Government. *Moline Water-Power Co.* v. *United States*, 20 Ct. Cl. 331 (1885).

Plaintiff's breach of contract claim rests on its misreading of the parties' Disaster Assistance Agreement and attendant OEP regulations. For its argument plaintiff relies on paragraphs 3 and 6 of the parties' Agreement which provide:

> 3. Federal assistance will be made available in accordance with Public Law 875, 81st Congress, as amended, Executive Orders 10427 and 10737, and the Regulations attached hereto.
>
> * * * * *
>
> 6. Federal financial assistance will be made available in accordance with Exhibit A which is attached hereto and made a part hereof.

Of the OEP regulations referred to in paragraph 3 above, plaintiff relies on OEP Circulars 4000.4 and 4000.5A. Both Circulars contain nearly identical provisions concerning the categories of costs incurred by applicants, and eligible for Federal assistance.

Section VI, E of OEP Circular 4000.4 provides:

> E. CATEGORIES OF ELIGIBLE COST
>
> Only certain costs incurred in disaster operations are eligible for reimbursement. The following paragraphs describe specific items which are clearly eligible or clearly ineligible. Project applications and vouchers * * * should be submitted accordingly * * *.
>
> * * * * *
>
> 3. Costs for Work Performed Under Contract
>
> a. Eligible
>
> Costs for work performed by private contractors on eligible projects.

It is plaintiff's argument that since under the terms of the parties' Agreement OEP must provide financial assistance in

accord with its regulations, including OEP Circulars, and that since those Circulars provide that plaintiff will be reimbursed for the cost of eligible work performed by private contractors that accordingly OEP must reimburse plaintiff for the costs of all such work performed and its failure to do so is a breach of the parties' Agreement.

The critical defect in this argument is that the OEP Circulars plaintiff relies on for its breach claim are neither incorporated by reference into the parties' Agreement as terms governing defendant provision of Federal assistance to plaintiff nor do they state an express obligation on defendant's part to reimburse plaintiff all of its eligible private contractor costs. The "Regulations" specified in paragraph 3 of the parties' Agreement as governing defendant's provision of Federal assistance and attached to the Agreement refer not to OEP Circulars but to agency regulations promulgated in the Federal Register [9] a copy of which did accompany the parties' Agreement. The OEP Circulars were neither promulgated by the agency as regulations, identified in the parties' Agreement nor even attached to the Agreement. In suing for a breach of contract plaintiff must rely on the express terms of the contract and cannot, as it has attempted to do here, import into the agreement terms outside of those expressly contained in the agreement. *New Jersey Foundry and Machine Co.* v. *United States*, 49 Ct. Cl. 235 (1914). As the OEP Circulars plaintiff relies on for its breach claim are not express parts of the parties' Agreement, plaintiff cannot sustain a breach claim by reliance upon them.

The OEP Circulars themselves do not obligate defendant to reimburse plaintiff all of its eligible private contractor costs. The Circulars are general issue manuals of the OEP entitled "Instructions to Applicants, Natural Disaster Program", and intended as noted in their "Forward" to provide instructions and guidance to State and local officials in applying for assistance under the Federal Disaster Act to supplement State and local expenditures in major disasters. Rather than being an express part of the parties' Agreement intended to obligate defendant to reimburse all of plaintiff's eligible private contractor costs, the Circulars are the docu-

[9] 32 C.F.R. § 1710 (1967).

ments referred to by the legend at the top of plaintiff's Project Application forms which reads: "Before completing this application, See Instructions." The "Conditions of Eligibility" section of the Circulars appertaining to the eligibility criteria relied on by plantiff makes clear that under the Circulars defendant was not obligating itself to reimburse plaintiff for all of its costs meeting the eligibility criteria of the Circulars:

> B. CONDITIONS OF ELIGIBILITY
>
> * * * * *
>
> 4. Eligibility criteria listed in this chapter limit the amount of reimbursement *which may be made available* to the applicant for the cost of emergency work. * * * [Emphasis added].

Even the provisions of the parties' Agreement upon which plaintiff relies to support its contention that under the parties' Agreement defendant is obligated to underwrite the entire amount of plaintiff's eligible costs expressly recognize that defendant's reimbursement obligation to plaintiff extends only up to the amount of funds authorized by the President rather than up to the total cost plaintiff incurs for such work. Paragraph 6 of the parties' Disaster Assistance Agreement, set forth above, refers to Exhibit A attached and incorporated as part of the parties' Agreement. Paragraph 1 of Exhibit A provides:

> 1. General. Federal financial assistance shall be provided *in accordance with the amounts set forth in paragraph 5 of the Agreement* and pursuant to Part 1710.9 of the regulations. [Emphasis added].

Paragraph 5 of the Agreement is the funding provision of the parties' Agreement specifying the amounts authorized for expenditure under the Agreement. Paragraph 5 of the parties' Agreement, as last amended, provided that Federal assistance to the State would be limited to the amount of funds "authorized by the President." As previously noted there is no evidence in the record that the President ever authorized OEP to expend more than the ten million dollars it provided in Federal disaster assistance to plaintiff.

Contrary to plaintiff's argument the provisions of the Circulars dealing with the reimbursability of eligible private contractor costs incurred by plaintiff are only, as their name implies, instructional and definitional in format and purpose, intended to describe those costs which defendant may reimburse plaintiff for, and do not state a binding obligation on the part of OEP to reimburse all such costs. They merely detail the rules governing plaintiff's application for, rather than defendant's provision of, Federal assistance under the Act. *Port Authority of the City of Saint Paul* v. *United States*, 193 Ct. Cl. 108, 113, 432 F. 2d 455, 457 (1970).

Like plaintiff's breach argument its contention that defendant's refusal to reimburse two of plaintiff's counties the full cost of their private contractor's billings was arbitrary and capricious action must fail. Even if the court were to accept plaintiff's factual assertions as to the inaccuracy of defendant's damage estimates in the two counties and that OEP deliberately revised the Bovay Report on the merits of plaintiff's claims for the sole purpose of diverting criticism from the agency, the uncontested facts still remain that all the Federal Disaster Act called for; all the parties' Agreement provided for; and all the OEP obligated itself to plaintiff to do was provide Federal assistance up to the monetary limits authorized by the President. Defendant having done this its actions in refusing to provide additional assistance beyond the financial limits authorized by the President, who under the Act and the parties' Agreement had sole authority to determine the amount of Federal assistance available to States "in carrying out their responsibilities to alleviate suffering and damage resulting from major disasters" cannot be adjudicated as arbitrary and capricious as to entitle plaintiff to judgment.

Judicial enforcement of consensual and statutory limitations on the extent of defendant's fiscal liability in an undertaking is by far the customary rather than the extraordinary in the field of Federal contracting. *Spearin* v. *United States*, 248 U.S. 132 (1918); *Sutton* v. *United States*, 256 U.S. 575 (1921); *Lockheed Aircraft Corp.* v. *United States*, 192 Ct. Cl. 36, 426 F. 2d 322 (1970). In defendant's provision of Federal assistance such enforcement becomes all the more necessary

because of the view we accepted in *Port Authority of the City of Saint Paul*, *supra*, 193 Ct. Cl. 117, 432 F. 2d at 460, that in a major disaster OEP could anticipate requests for assistance in excess of available funds. Correspondingly, the President must anticipate major disasters across the country generating requests for assistance in excess of his disaster relief appropriation from Congress. In *Port Authority of the City of Saint Paul*, we approved OEP's actions in limiting Federal assistance to public facilities other than those leased to private interests as a reasonable measure to conserve OEP's limited resources. Likewise in the instant case we uphold OEP's actions in limiting Federal assistance to the amount of funds authorized by the President as a reasonable measure to assure that funds will be available to render Federal assistance in other major disasters.

Such enforcement of limiting provisions in Federal-State Disaster Assistance Agreements is also necessary to further the express intent of Congress under the Act. Congress enacted the Federal Disaster Assistance Act with the full knowledge that funding would never be sufficient to provide complete relief in times of major disaster [10] but with the noble purpose of providing "an orderly and continuing means of *assistance* by the Federal Government to States and local governments in carrying out *their responsibilities* to alleviate suffering and damage resulting from major disasters." During Congressional consideration of the Act one of the sponsors of the bill which eventually became the Federal Disaster Act succinctly set out the eleemosynary but understandably limited Congressional purpose behind providing Federal assistance to the States in times of major disasters, and completely refuted plaintiff's argument that the Government must pay *all* of plaintiff's eligible costs:

> Mr. MCCLELLAN. Mr. President, I do not think anyone should gain the erroneous impression that it is the purpose that this bill shall apply to all losses occurring in the United States, so that everyone who sustained a loss might be compensated by the Government. If anyone is laboring under that impression, it certainly is not the intent of the Congress and it is not the intent of the sponsors of the bill. The purpose of the bill is to meet

[10] 96 Cong. Rec. 11895–11915 (1950).

> emergency needs, and to meet a situation which the local people cannot meet except at the cost of great suffering and hardship. It is not to make whole everyone who may lose property or may sustain damage. If we were going to do that, of course, the Government would get into everything. * * *[11]

In summary, on the record before us, the court finds that following the devastation of Texas in 1967 by Hurricane Beulah the President authorized ten million dollars in Federal assistance to the State. OEP expended the authorized funds and fulfilled its obligations to provide "assistance" to Texas in response to the disaster which it encountered. This Presidential action and the corresponding action of the OEP of fully providing the authorized amounts of Federal assistance to plaintiff fully and reasonably complies with the requirements of the Federal Disaster Act and the parties' Disaster Assistance Agreement. Accordingly plaintiff, after already having received ten million dollars in Federal assistance, cannot prevail on its claims seeking an additional $600,000 from defendant.

Granted is defendant's motion for summary judgment. Denied is plaintiff's cross-motion, and its petition is dismissed.

NICHOLS, *Judge*, concurring:

I join in the court's decision and in its opinion, which I deem clearly right, except to the extent stated. However, I note that defendant made a strong argument that the authorization in 42 U.S.C. § 1855b, as it then was, to make "contributions" to "States and local governments" did not include authority to make binding contracts, but only gratuitous contributions, which might be withheld at pleasure. As to this it relied on the closing sentence of the section:

> * * * The Federal Government shall not be liable for any claim based upon * * * a discretionary function or duty on the part of a Federal agency or an employee of the Government in carrying out the provisions of this section.

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[11] 96 Cong. Rec. 15097 (1950).

Though this language is cryptic in a contract authorization context, defendant argued from legislative history, not unpersuasively, that it was meant to safeguard the United States from being sued by any state that did not think its allocation of Federal disaster relief sufficient.

The court, to refute this, cites *State of Arizona* v. *United States*, 204 Ct. Cl. 171, 494 F. 2d 1285 (1974). However, the conclusion there reached, that the United States was contractually liable to pay Arizona its agreed share of Federal Aid for Highway funds, was not difficult to arrive at in light of 23 U.S.C. § 106(a), which declares that the Secretary's approval of a State highway project:

> * * * shall be deemed a contractual obligation of the Federal Government for the payment of its proportional contribution thereto. * * *

There is no such provision to aid us here. The Supreme Court in *United States* v. *Testan*, 424 U.S. 392 (1976), has recently demanded, or seemed to demand, that we look for statutory language of just this kind before holding the Government liable in any Tucker Act (28 U.S.C. § 1491), litigation. If not expressed, it should at least be clearly implied. I fail to find it in the Disaster Relief legislation.

This difficulty could obtain at the outset and perhaps could be met upon the making of a formal contract, as here, to the extent of the contract terms. Since Texas loses anyway, it is perhaps unnecessary to go into the impact of the *Testan* doctrine now. It will probably be a long time before we all easily agree as to just what otherwise valid claim is barred because of *Testan*. Defendant's position leaves much uncertainty as to how it would have implemented the statute, since it presumably would not wish to put itself in the position of having made contracts that could not be authoritatively construed by a court if any dispute arose. Similar problems may arise under the current provision for Disaster Relief in 42 U.S.C. § 5121 and ff. This is much more elaborately worked out, but the provisions giving me trouble seem to recur.

Instead of holding flatly that the *Federal-State Disaster Assistance Agreement* here involved was just as much a contract as the one in the *Arizona* case, I would have assumed *arguendo* that this was so, and gone on to demonstrate, as the

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court persuasively does, that the supposed contract does not provide basis for the claim Texas makes in this case.

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538 F. 2d 888

FRANK A. RAMIREZ v. THE UNITED STATES

[No. 312-75. Decided July 9, 1976]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; limitations on assessment and collection; income tax.—Plaintiff seeks refund of that part of his 1967 income tax which was collected as a deficiency, contending that the assessment thereof was barred by the statute of limitations. On December 12, 1970 plaintiff agreed in writing to extend until June 30, 1972 the period during which a timely assessment could be made of his 1967 tax, with the proviso that if plaintiff were noticed of a deficiency "on or before that date" the time for making an assessment would be "extended beyond that date" by the number of days during which an assessment was prohibited and for 60 days thereafter. On March 14, 1972 a statutory notice of deficiency was sent to plaintiff, and on September 4, 1972 a deficiency was assessed. Upon disallowance of his claim for refund, plaintiff filed the present action. It is *held* that in view of Sec. 6213(a) no assessment of the deficiency could have been made for 90 days, and accordingly, under the express terms of the agreement and the proviso, the period during which the Government could properly assess a tax deficiency was extended 90 days beyond the June 30, 1972 original cutoff date, and for 60 days thereafter, or, until November 27, 1972. The assessment, made on September 4, 1972 was therefore within the period of the extension. The same result, without the aid of the automatic extension proviso contained in the extension agreement, may be reached under Sec. 6503(a)(1) which, itself, suspends the running of the limitations period. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

Taxes; limitations on assessment and collection; extension by agreement.

[1] Where, pursuant to agreement, the period during which a timely assessment of taxpayer's 1967 income tax could be filed was extended to June 30, 1972 with the proviso that if a notice of tax deficiency were sent to him on or before that date (which it was), the time for making an assessment "shall be extended beyond that date by the number of days during which an assessment is prohibited and for sixty days thereafter," in view of Sec. 6213(a) of the In-

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ternal Revenue Code of 1954 prohibiting assessment of a deficiency in tax for 90 days from the date of notice, the time for making any assessment was extended by 90 days plus 60 days thereafter, or a total of 150 days.

Internal Revenue ⟸ 1404

Taxes; limitations on assessment and collection; suspension of running of limitations period.

[2] The specific language of the automatic extension proviso contained in the subject consent agreement effectuated the policy underlying Sec. 6503(a)(1) which suspends the running of the period of limitations, upon the mailing to taxpayer of a notice of deficiency, for the period during which an assessment is prohibited and for 60 days thereafter, whereby the Government is not foreclosed from making an assessment because the following 90 days would run past the contractually extended cutoff date.

Internal Revenue ⟸ 1408

Taxes; limitations on assessment and collection; "suspension" v. "extension" of limitations period.

[3] For purposes of the instant case, whether the limitations period was "extended," as it was, under Sec. 277(b) of the Revenue Act of 1924, or "suspended" under Sec. 6503(a) of the current Code, the change in wording did not affect the manner in which the enlargement was to be applied, i.e. when the period of suspension or extension ceases, the limitations period again commences to run.

Internal Revenue ⟸ 1404

Taxes; limitations on assessment and collection; suspension of running of limitations period.

[4] In entering into the agreement for extension of the period for tax assessment under authority of Sec. 6501(c)(4) of the Code, the extended contractual period of limitation was as much a period of limitations provided for in Sec. 6501 and subject to the automatic suspension in Sec. 6503(a)(1) as was the otherwise controlling general 3-year period provided for in Sec. 6501(a).

Internal Revenue ⟸ 1408

Michael C. Ferguson, attorney of record, for plaintiff.

Rose Anne Featherston, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Robert S. Watkins*, of counsel.

Before LARAMORE, *Senior Judge*, DAVIS, and SKELTON, *Judges*.

Opinion of the Court

LARAMORE, *Senior Judge*, delivered the opinion of the court:

In this suit for refund of Federal income tax,[1] plaintiff (hereinafter "taxpayer") contends that the government's assessment of a deficiency in his income tax for 1967 was barred by the statute of limitations. The record does not specifically address the merits of the tax assessed, nor is there any controversy as to the amount of the tax collected. Hence, our consideration is limited solely to the question of whether the assessment was made in a timely fashion. For reasons enunciated below, we hold that it was.

The material facts are not in dispute. On December 12, 1970, taxpayer agreed in writing to extend until June 30, 1972 the period during which a timely assessment could be made of his 1967 income tax. The period would otherwise have expired on April 16, 1971.[2] The agreement, executed by both taxpayer and the government, was a standard Internal Revenue Service Form 872 entitled, "Consent Fixing Period of Limitation Upon Assessment of Income and Profits Tax," which reads, in pertinent part, as follows:

> [The taxpayer and the government consent and agree] [t]hat the amount of any Federal income and profits taxes due under any return (or returns) made by or on behalf of the above-named taxpayer (or taxpayers) for the taxable year ended December 31, 1967 under existing or prior revenue acts, may be assessed at any time on or before June 30, 1972 except that if a notice of a deficiency in tax is sent to the taxpayer (or taxpayers) by certified or registered mail on or before that date, then the time for making any assessment shall be extended beyond that date by the number of days during which an assessment is prohibited and for sixty days thereafter.[3]

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[1] All citations hereinafter made to the "Code," or to sections contained therein, are, unless otherwise indicated, in reference to the Internal Revenue Code of 1954.

[2] Section 6501(a) provides, with exceptions not here relevant, that the amount of any tax imposed by the Code shall be assessed within three years after the return reporting such tax was filed. Section 6501(b)(1) provides that returns filed before the last day prescribed by law for the filing thereof shall be considered as filed on the last day. See also Treas. Reg. § 301.6501(b)–1(a). In the instant case, under section 6072(a), taxpayer's 1967 return was due on or before April 15, 1968. Therefore, the 3-year statute of limitations commenced running on April 16, 1968, and would have expired on April 16, 1971.

[3] Except for the dates December 31, 1967 and January 30, 1972, which were typewritten, all of the language quoted above was in printed form.

On March 14, 1972, taxpayer was sent, by certified mail, a statutory notice of a deficiency in his 1967 income tax. The deficiency was assessed against him on September 4, 1972. Collection was accomplished by compulsorily applying overpayments inadvertently made in respect of later years' taxes (1972 and 1973) in satisfaction of the earlier deficiency.

Subsequently, taxpayer filed a claim with the Internal Revenue Service for refund of that part of his 1967 income tax which had been collected as a deficiency. The claim, which alleged only that the assessment of the deficiency had been barred by the statute of limitations, was in due course disallowed. Thereafter, this suit followed.

Inasmuch as taxpayer grounds his right to recovery upon the sole argument that the assessment of the tax was not effective until after the statute of limitations had outlawed it, logic dictates that we first examine the relevant statute or statutes relating to the limitation of assessments. Section 6501(a)[4] embodies what may be referred to, for Federal tax assessment purposes, as a general statute of limitation. It directs that, unless otherwise provided, the amount of any tax imposed by the Internal Revenue Code be assessed within three years after the date on which the return for such tax was filed. Section 6501(c)(4),[5] however, permits a taxpayer and the government to mutually consent to enlarge, by written agreement entered into prior to the expiration of the natural period of limitation, the time within which any tax, except an estate tax, may be timely assessed.

In the case at bar, taxpayer and the government implemented subsection (c)(4) through the written agreement set

[4] "SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

"(a) GENERAL RULE.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period."

[5] [Sec. 6501] "(c) EXCEPTIONS.— * * * (4) Extension by Agreement.—Where, before the expiration of the time prescribed in this section for the assessment of any tax imposed by this title, except the estate tax provided in chapter 11, both the Secretary or his delegate and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon."

out in the paragraph above. The undisputed effect of the language therein used was to extend the expiration date of the statutory period, at the very least, to June 30, 1972. However, were June 30, 1972 an immutable cutoff date, taxpayer would, without more, prevail in this case because the assessment, on September 4, 1972, was made more than two months later. But we note that the agreement contained a proviso which specified that if a notice of deficiency were sent to the taxpayer before that date (meaning June 30, 1972), then the time for making an assessment would be further extended. Such a notice was sent on March 14, 1972. Thus, the precise number of days by which the June 30, 1972 original cutoff date was extended upon the sending of the notice, determined the timeliness *vel non* of the assessment.

Further scrutiny of the agreement is necessary. The formula used in the agreement under which the contractual limitation period was to be extended, incorporated by reference a calculable but unspecified measure. It provided that the time for making any assessment would be extended (after the notice of deficiency was sent) by the number of days during which an assessment would be prohibited, and for 60 days more.

Dual issues are raised by this formula. One concerns the numerical measure used, *i.e.*, the number of days. However, both parties urge that 90 days is the correct figure. In light of section 6213(a),[6] we agree. That section provides (with certain exceptions not relevant here) that where the government issues a notice of a deficiency, the tax may not be as-

[6] "SEC. 6213. RESTRICTIONS APPLICABLE TO DEFICIENCIES; PETITION TO TAX COURT.

"(a) Time for Filing Petition and Restriction on Assessment.—Within 90 days, or 150 days if the notice is addressed to a person outside the States of the Union and the District of Columbia, after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. Except as otherwise provided in section 6861 no assessment of a deficiency in respect of any tax imposed by subtitle A or B or chapter 42 and no levy or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day or 150-day period, as the case may be, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. Notwithstanding the provisions of section 7421(a), the making of such assessment or the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court."

sessed until 90 days have expired. Evidently, this period permits the taxpayer time to resist the deficiency, either administratively or by filing a petition in the Tax Court. In any case, 90 days is the proper measure to be incorporated into the agreement, and the time for making any assessment was, thus, to be extended for 90 days and 60 days thereafter, or a total of 150 days.

The other, more debated issue, concerns the manner in which the contractual limitation period was to be enlarged. Taxpayer contends that the 150 days was intended to run from the date the notice of deficiency was sent (March 14, 1972) or only until August 11, 1972. This interpretation would bar the September 4, 1972 assessment.

Two subarguments are said, by taxpayer, to buttress this contention. The first is that the phrase "that date," used for the second time in the agreement, referred not to June 30, 1972, but to the date upon which the notice of deficiency was sent. Taxpayer, therefore, takes the position that the phrase "that date" twice used in the agreement, referred to two different dates.

After examining the language of the agreement, we are unable to accept this line of reasoning. It is not reasonable to assert that the phrase "that date", used twice in the same sentence, referred to two separate dates, without any hint that it did in the language itself. The only date set forth in the agreement that refers to the assessment was June 30, 1972. Under the plain wording of the agreement, which belies the construction taxpayer would place upon it, taxpayer's position is patently incorrect, and we need not devote any more time to this facet of his argument.

Taxpayer's second point is that the agreement at bar, and in particular the extension proviso contained therein, must be read not merely in *pari materia* with section 6213(a) of the Code (providing for the 90-day prohibition upon assessment), but also in light of the effect that section could have upon the making of an assessment within a period of limitation extended by agreement. Taxpayer perceives that, in the absence of an automatic extension proviso, the government could find itself in the anomalous position of sending

a notice of deficiency near the end of a contractual limitation period and being foreclosed from ever making the assessment because the following 90 days would run past the contractually extended cutoff date. The proviso is said to be designed specifically to avoid this pitfall by allowing the government a 60-day grace period immediately after the 90 days comes to an end.

While this argument of taxpayer has appeal insofar as it signals the *animus* behind the proviso, we think that the taxpayer has, more or less, jumped to the conclusion that a "fair" construction of the language must allow for only the shortest extension of the contractual limitation period that would assure the government an opportunity to assess in a timely fashion. This is not necessarily so. The rather explicit language of the proviso provides that the 150 days be applied so as to "extend" the contractual limitation period by that amount, and the wording of the proviso admits of no other tenable construction.

In point of fact, at the time the agreement was executed the identical result was already assured by the Code. Section 6503(a)(1)[7] suspends the running of the period of limitations, when a notice of deficiency is sent, for the period during which an assessment is prohibited and for 60 days thereafter. In light of the striking similarity between section 6503 (a)(1) and the proviso contained in the agreement, we think the latter was designed to foster the policy underlying the former. That is to say, the section and proviso avoid in the identical manner the pitfall to which taxpayer refers.

Moreover, this is a conclusion we draw not by mere cursory comparison of the corresponding language of section 6503 (a)(1) and the proviso. Our research discloses that section

[7] "SEC. 6503. SUSPENSION OF RUNNING OF PERIOD OF LIMITATION.

"(a) ISSUANCE OF STATUTORY NOTICE OF DEFICIENCY.—

"(1) GENERAL RULE.—The running of the period of limitations provided in section 6501 or 6502 on the making of assessments or the collection by levy or a proceeding in court, in respect of any deficiency as defined in section 6211 (relating to income, estate, gift and chapter 42 taxes), shall (after the mailing of a notice under section 6212(a)) be suspended for the period during which the Secretary or his delegate is prohibited from making the assessment or from collecting by levy or a proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter."

277(b) of the Revenue Act of 1924,[8] precursor to section 6503(a)(1) of the current Code, used the word "extended" to achieve the same effect that "suspended" achieves in the current section of the Code. Apparently, in the Revenue Act of 1926, section 277(b),[9] Congress varied the term used to describe the manner under which the limitation period was to be automatically enlarged in certain instances. The 1924 Act provided that the limitation period would be "extended", while the 1926 Act provided that the running of the limitation period would be "suspended." With either of these terms, the manner in which the limitation period was to be enlarged is identical. We find little distinction, for purposes of the instant case, in saying on the one hand that a period is to be "extended" by 90 days and, on the other hand, that the running of a period is to be "suspended" for 90 days. Thus, the change from "extension" to "suspension" in the tax statutes had, for purposes of our analysis, no apparent effect on the manner in which the enlargement was to be applied.

In *Continental Oil Co.* v. *United States*, 83 Ct. Cl. 344, 14 F. Supp. 533, *cert. denied*, 301 U.S. 694 (1936), after quoting from both statutes, we applied the formula of the 1926 Act by taking the original period of limitations, allowing a number of days of suspension during which the period was tolled, and then at the end adding the unexpired period. It is readily apparent that if the term "extended" had been used, the same effect would have been achieved.

This analysis of the legislative switch from "extended" to "suspended" suggests that because no change in effect was intended, a prior opinion of this court which has already con-

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[8] Section 277(b) of the Revenue Act of 1924, states as follows:

"*The period within which an assessment is required to be made by subdivision (a) of this section in respect of any deficiency shall be extended* (1) by 60 days if a notice of such deficiency has been mailed to the taxpayer under subdivision (a) of section 274 and no appeal has been filed with the Board of Tax Appeals, or (2) if an appeal has been filed, then by the number of days between the date of the mailing of such notice and the date of the final decision by the Board." [Emphasis supplied.]

[9] Section 277(b) of the Revenue Act of 1926, provides in part:

"*The running of the statute of limitations provided in this section or in section 278 on the making of assessments and the beginning of distraint or a proceeding in court for collection, in respect of any deficiency, shall (after the mailing of a notice under subdivision (a) of section 274) be suspended* for the period during which the Commissioner is prohibited from making the assessment or beginning distraint or a proceeding in court, and for 60 days thereafter." [Emphasis supplied.]

strued the use of "suspended" in a context similar to the case at bar, should be helpful and persuasive in our effort to treat the proviso's use of the word "extended." In *Olds & Whipple, Inc.* v. *United States*, 86 Ct. Cl. 705, 724, 22 F. Supp. 809, 819 (1938), the court stated:

> * * * [*T*]*he Commissioner is entitled, in making the assessment of a deficiency determined by the Board, to use the sixty-day period together with any unexpired portion of the statute of limitation remaining at the time it became suspended by the mailing of the deficiency notice.* We think the language of the statute is not reasonably susceptible to any other construction. It plainly states that the running of the statute of limitation shall be suspended and this can only mean that when the period of suspension ceases the limitation period again commences to run. [Emphasis supplied.]

And the court summarized this point, *Id.* at 725, 22 F. Supp. at 819:

> * * * Upon our interpretation of section 277(b) of the Revenue Act of 1926 as amended and section 277 of the Revenue Act of 1928, the statute of limitation *as extended by the suspended period* did not expire as to * * * [the years in question, prior to the date of the assessment.] [Emphasis added. Note the juxtaposition of the words "extended" and "suspended".]

The result of "tacking" reached by the court in *Olds & Whipple, Inc.*, *supra*, under section 277(b) of the Revenue Act of 1926, is no different than that mandated by the express language of the agreement and proviso presently under consideration.

On the facts of this case, a statutory notice of deficiency was sent to taxpayer on March 14, 1972, and under section 6213(a), as mentioned above, no assessment of the deficiency in taxes could have been made for 90 days. Therefore, under the express terms of the agreement, and the proviso contained therein, the period during which the government could properly assess a tax deficiency was extended 90 days beyond the June 30, 1972 original cutoff date, and for 60 days thereafter, or, until November 27, 1972. The assessment, made on September 4, 1972, was therefore within the period of the extension provided for by the proviso in the agreement.

Finally, one further wrinkle needs to be covered. While our consideration of this case has been aimed, and the briefs of the parties have been directed, toward a construction of the subject agreement and the automatic extension proviso contained therein, we cannot neglect to note that the same result would have been reached merely by pointing to section 6503(a)(1) which, itself, suspends the running of the period of limitations.

Section 6503(a)(1) applies to the "* * * running of the period of limtations provided in section 6501 * * *." Since the agreement entered into between the parties was clearly done under authority of section 6501(c)(4), the extended contractual period of limitation was as much a "period of limitations provided for in section 6501" as was the otherwise controlling general 3-year period provided for in section 6501(a). Consequently, upon the mailing of the notice of deficiency by the government, section 6503(a)(1), on its own, suspended the extended contractual period of limitation for the same 150 days and, without the aid of the automatic extension proviso in the agreement, the assessment would have been timely in any case.[10]

Accordingly, for the foregoing reasons, defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

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544 F. 2d 1070

DECCA LIMITED v. THE UNITED STATES

[No. 299–70. Decided July 9, 1976]

ON THE PROOFS

Patents; infringement; place of use; territorial extent of patentee's rights; worldwide radio navigation system.—Plaintiff seeks reason-

[10] This second interpretation of the case, like the first one based upon the effect of the automatic extension proviso, relies upon both *Continental Oil Co.* v. *United States, supra,* and *Olds & Whipple, Inc.* v. *United States, supra.* In doing so, both interpretations specifically adhere to the "tacking" principle mentioned, where under either the extension agreement or section 6503(a)(1) the period during which an assessment is prohibited and 60 days more is "tacked" on to the limitation period. To the extent that *Hoosac Mills Corp.* v. *Commissioner,* 75 F. 2d 462 (1st Cir. 1935), cited by taxpayer in the instant case, departs from this formula, we decline to follow it. *Accord, Aura Grimes Bales* v. *Commissioner,* 22 T.C. 355 (1954). *See also, Olds & Whipple, Inc.* v. *United States, supra,* at 724, 22 F. Supp. at 819.

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able compensation under 28 U.S.C. § 1498 for the alleged infringement of claims 1, 4 and 11 of its patent No. 2,844,816 by the worldwide Omega navigation system sponsored by the United States. Defendant contends that the patent is invalid because the disclosed embodiment is inoperative and fails to meet the requirements of 35 U.S.C. § 112, that the Omega system is not covered by the claims in issue, and that to the extent the case for infringement is based on United States-owned equipment located in foreign countries (at present, Norway only) the United States patent laws extend only to the territorial limits of the United States and preclude recovery based on equipment on foreign soil. For the reasons stated, it is *held* that plaintiff has carried its burden of proving infringement of the claims in issue and that defendant has not established invalidity of the patent on the grounds stated. It is further *held* that the whole Omega system must be deemed, at least for purposes of litigating the subject patent, to be a unity and that the location of that unity must be deemed to be in United States territory since the transmission from the Norwegian station is controlled by the United States in the sense that the system establishes, continously monitors and synochronizes the signals in the United States from the Norwegian station. *Deepsouth Packing Co.* v. *Laitram Corp.*, 406 U.S. 518 (1972), *distinguished*. Accordingly, claims 1, 4 and 11 have been infringed by defendant, plaintiff is entitled to recover, and judgment is entered to that effect, the amount of recovery to be determined in further proceedings.

Patents; infringement; place of sale or use; territorial extent of patentee's rights.

[1] The United States patent laws are territorial in their application and by their own terms are not infringed by acts in foreign countries that would be infringements at home. *Deepsouth Packing Co.* v. *Laitram Corp.*, 406 U.S. 518 (1972).

Patents ⇦ 189

Patents; operability; generally.

[2] The mere fact that the patented system has some drawbacks, or that under certain postulated conditions it may not work, or that better, more sophisticated equipment has been developed which does a better job, does not detract from the operability of the disclosed equipment to perform its described function.

Patents ⇦ 1

Patents; operability; generally.

[3] Inoperativeness of an invention is not established merely by showing that the particular disclosed embodiment for carrying out the principles of the invention is lacking in perfection.

Patents ⇦ 16

Patents; specification; sufficiency of disclosure.

[4] To satisfy the requirements of 35 U.S.C. § 112 it is enough that one of ordinary skill in the art would be able to understand the

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patent disclosure and, from that disclosure, using the skill of the art, could build an operative system.

Patents ⇐ 118

Patents; infringement; identity of function or operation.

[5] More than a literal response to the terms of patent claims must be shown to make out a case of infringement. It must also be shown that the accused system does substantially the same work in substantially the same way to accomplish substantially the same result as the claimed system.

Patents ⇐ 226.7

Patents; infringement; evidence; combinations.

[6] The mere fact that one or more elements of an accused combination are susceptible of noninfringing uses does not mean that all systems employing those same elements avoid infringement. Hence, testimony that the same general purpose computers are used in noninfringing systems is irrelevant to the question of whether the computer, when combined with other elements of the accused system, infringes the patented navigational system.

Patents ⇐ 312(2)

Patents; infringement; process or method patent.

[7] Where the evidence supports the conclusion that the subject invention is a system which includes a receiver capable of performing the functions of synchronizing itself with the transmitted signals, separating the signals, and producing from those signals a fine and coarse readout, not the specific mechanism by which the receiver achieves those results, infringement is not avoided by showing that digital instead of analog techniques are used in the accused system.

Patents ⇐ 264

Patents; patentability; mental steps.

[8] Computer programs are not patentable per se. (*Gottschalk* v. *Benson*, 409 U.S. 63 (1972)).

Patents ⇐ 16.2

Patents; infringement; what constitutes; improvement.

[9] Merely because the accused system is an improvement over the patented system does not mean that it does not also infringe the patent.

Patents ⇐ 264

Patents; license; use by Government; eminent domain taking.

[10] Governmental use of a patented invention is viewed as an eminent domain taking of a license under the patent and not as a tort. From the standpoint of a "use" by the United States, a cause of action under 28 U.S.C. § 1498 arises when the accused equipment is first available for use, and it is when the use occurs that a license is considered to have been taken. It is this taking of a license, without compensation, that is, under an eminent domain theory, the basis for a suit under § 1498. In the present action, it is when the receiver

Per Curiam

receives the signals in the United States that there is a completed use of the patented system.

Eminent Domain ⇐ 45

Patents; infringement; place of sale or use; territorial extent of patentee's rights.

[11] A combination worldwide radio navigation system for ships and aircraft which by its very nature has to have transmitters located in the United States and outside its territorial boundaries, and all of whose signals are not only established, monitored and synchronized from the United States to obtain an exact fix but whose beneficial use occurs within the United States, even though one United States-owned station is located in a foreign country, for purposes of the territorial requirements of the United States patent laws is deemed a unity whose base is in the United States where the "master" station or stations are located.

Patents ⇐ 189

Robert B. Russell, attorney of record for plaintiff. *Henry C. Nields, and Russell & Nields*, of counsel.

Joseph A. Hill, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Paul F. Arseneau*, of counsel. *Albert Sopp*, Naval Electronic Systems Command, Department of the Navy, of counsel.

Before NICHOLS, KASHIWA, and KUNZIG, *Judges*.

PER CURIAM: This case comes before the court on defendant's exceptions to the recommended opinion, findings of fact and conclusion of law of former Trial Judge Cooper, submitted in accordance with Rule 134(h), in which he holds that the United States has infringed *within the United States*, claims 1, 4 and 11 of O'Brien, et al., United States Patent No. 2,844,816, and must pay reasonable and entire compensation under 28 U.S.C. Sec. 1498, the amount thereof being left to future proceedings under Rule 131(c). The alleged infringing device is the United States Government's worldwide Omega system for positioning ships and aircraft. The case has been submitted to the court on the briefs and arguments of counsel. Upon consideration thereof, since the court agrees with the said recommended decision, except for one sentence, it adopts the same as the basis for its decision in this case, except for that sentence, which we have deleted.

We agree in general with the trial judge's handling of the extraterritoriality problem, but have eliminated a sentence to avoid giving the impression that we rely on what we believe to be the not unchallengeable proposition, that the territorial requirements of the United States Patent Laws are met simply because United States flag vessels or aircraft, receiving Omega signals while on or over the high seas, are ambulatory portions of United States territory. We think the territorial requirements of our laws are met otherwise in this case, so this juridical prop is not necessary.

The problem arises from the fact that, as held in *Deepsouth Packing Co.* v. *Laitram Corp.*, 406 U.S. 518 (1972), United States Patent Laws are territorial in their application and by their own terms are not infringed by acts in foreign countries that would be infringements at home. That case excluded shipment abroad of components of shrimp deveiners, for assembly there, although they had been held, when assembled at home, to infringe certain United States combination patents. The Court referred to provisions of the Patent Code, 35 U.S.C. Secs. 154 and 271, the former of which makes a United States Patent convey the right to exclude others from making, using, or selling the invention "throughout the United States" and the latter defines infringement as making, using, or selling the invention "within the United States". By Sec. 100(c) "United States" means "the United States of America, its territories and possessions". Patent claims, it was said, must moreover be construed strictly in light of "this Nation's historical antipathy to monopoly". 406 U.S. at 530.

It has several times been held that the fiction, as it has been called, that a United States flag vessel is United States territory, does not extend so far as to make general United States laws, enacted for territorial application, and without express reference to shipping, applicable to United States flag ships at sea. *United States ex rel. Claussen* v. *Day*, 279 U.S. 398 (1929); *Cunard S.S. Co.* v. *Mellon*, 262 U.S. 100 (1923); *Scharrenberg* v. *Dollar S.S. Co.*, 245 U.S. 122 (1917).

The parties, addressing this problem on inquiries from the bench, seem to have supposed the answer was primarily found in *Brown* v. *Duchesne*, 60 U.S. (19 How.) 183 (1857).

In that case a United States Patent was held not infringed by a device carried as part of the equipment of a French flag vessel to a United States port, because, it was held, an implied exception to the United States Patent Laws existed for that particular situation. Congress could not by its general language have intended to empower patentees to harass and obstruct foreign flag ships in our ports, fitted out in conformity to the patent laws of their own countries, and trading to our ports pursuant to treaties guaranteeing them equal access. That case is quoted and followed in *Benz* v. *Compania Naviera Hidalgo, S.A.*, 353 U.S. 138, 146 (1957), holding that United States Labor Laws do not apply to labor disputes on board foreign flag vessels during their temporary stays in United States ports.

In the situation of "flag of convenience" ships beneficially owned by United States nationals, but under foreign flags, the Supreme Court has had difficulty, whether and when to imply exceptions to United States Law of this kind. *Hellenic Lines Ltd.* v. *Rhoditis*, 398 U.S. 306 (1970); *McCulloch* v. *Sociedad Nacional*, 372 U.S. 10 (1963); *Lauritzen* v. *Larsen*, 345 U.S. 571 (1953). Sometimes it does so, sometimes not, as these cases illustrate.

In *Gardiner* v. *Howe*, 9 Fed. Cas. 1157 (1865), the court held that a United States Patent could be infringed by use on board a United States merchant vessel on the high seas. The court took the view that the United States Patent Laws extended to any place under United States jurisdiction. In *Marconi Wireless Tel. Co.* v. *United States*, 99 Ct. Cl. 1 (1942), *affirmed in part, vacated in part*, 320 U.S. 1 (1943), order on remand, 100 Ct. Cl. 566 (1943), this court followed *Gardiner* v. *Howe*, which it deemed, with *Brown* v. *Duchesne*, the only available authority, to hold that the Marconi patents were infringed by a group of receivers made and used at the United States Naval Radio Station at the American Legation in Peking, China. Though not mentioned in the opinion, it is of course well known that the United States then enjoyed extraterritorial rights at that location. The applicability of these cases today, to the instant problem, may be deemed questionable, both from their apparent inconsistency with *Cunard S.S. Co.* v. *Mellon* and *Deepsouth Packing Co.* v.

Laitram Corp., both *supra*, and still more, because the definition of "United States" in 35 U.S.C. Sec. 100(c) was only added to the Patent Code by the 1952 revision. *See*, 2 U.S. Code Cong. & Adm. News (1952) 2394, at 2409. Before then the Patent Laws did not define their own scope in a manner that so plainly confined them to states, territories and possessions. We do not, however, disapprove or overrule *Gardiner* v. *Howe* and *Marconi Wireless*. We only rely on them lightly and with hesitation.

It might be thought—and was in the *Marconi* case—that an implied exemption of foreign flag shipping from United States Laws, even when in United States ports, might as a logical corollary demand a corresponding extension of the same laws to United States ships, even though at sea or in foreign waters. However, an exception to a statute is always easier to imply than an extension is. Any such proposed extension would have to be considered on the merits of the case. Of course, when Congress expressly and consciously legislates for shipping or aircraft, the problem vanishes: it is solely one of construing general statutes. In the case of the Patent Laws the canon of hostile interpretation mentioned in the *Deepsouth* case provides an added obstacle to implying an extension of the United States Patent Laws to correspond to the exception implied in *Brown* v. *Duchesne*.

In view of the foregoing, we think a decision founded on the fiction that for purposes of the Patent Laws, United States ships and planes wherever found, are United States territory, would be founded on water. We think, however, that the question can be left open, and still we find enough other basis for concluding that the location of the infringement is within United States territory, not abroad as in *Deepsouth*.

The alleged infringing system, Omega, is fully described in the trial judge's opinion and findings. It is a worldwide United States Government system for broadcasting radio waves of a particular kind to be received on ships or aircraft by receivers able to receive and use them, to pinpoint the location of ships and planes on or over the sea. Loran does the same job, but Omega is expected to succeed it. The broadcasting equipment is designed and built by the United States

Government. There are two stations in the United States, and at present one in Norway, but others in foreign locations are projected. Two stations are necessary for a line of position, and three for an exact fix, by the meeting of two lines. The receivers in the ships or planes read the signals into computers and read out exact information as to location. The United States Government does not necessarily provide the receivers, and they can be of a variety of designs. The system would be worth little if it did not operate worldwide, at least as an ultimate goal, so that, a receiver once installed, the ship or plane can use it to navigate anywhere. Of its very nature the system cannot be confined to one country, but we do not think it is without any territoriality merely because it operates in more than one country, and at sea. Its home territory is, we think, where the broadcast stations are, but if they are in more than one country, the location of the whole for purposes of the United States Patent Law is where the "master" station or stations are, which is in the United States of America, and where all the stations are monitored, presently Washington, D.C. All stations broadcasting in the system have to be brought into exact synchronization with the United States stations. The receivers have to be programmed to receive and measure the time differences in arrival of signals and interpret these differences. Thus they are in a manner "slaves" just as the foreign stations are. We do not think that the necessarily scattered and changing position of receivers, with those actually functioning for the most part at sea, in or over the territory of no sovereign, have any necessary connection with the location of the Omega system for purposes of the United States Patent Laws. It is located in the United States. This analysis agrees with that of the Patent Office Board of Patent Interferences. *Rosen* v. *NASA*, 152 USPQ 757 (1966), holding that an invention concerning space satellites was reduced to practice in the United States because of the location of control stations here.

This view does not claim an extraterritorial effect for United States Patent Laws, as did the view rejected in *Deepsouth*, *supra*. Neither is there a probable conflict with the patent laws of other countries. It could perfectly well have been that the assembly of the shrimp deveiners, *e.g.*, in Brazil, could have been of concern to the patent laws of Brazil, which

might have provided different consequences for the assembly than the United States laws would have. Here, if a foreign country, host to a "slave" broadcast station, attempted to apply its patent laws to that station in a harassing way, we suppose it would be viewed like the attempted application of United States Law to the French ship in *Brown* v. *Duchesne*. It would be an anomaly, though not impermissible. The French were not given extraterritoriality there. Any foreign country that consents to the entry of any element of the Omega system into its territory impliedly consents also, it would seem, to abstain from any application of its own patent law that would interfere with the intended use. If it breached this implied understanding, the remedy would be not to claim extraterritoriality but to remove the station.

At any rate, the whole Omega system must be deemed, at least for purposes of litigating the patent here involved, to be a unity, and the location of that unity must be deemed to be in United States territory. Here it has planted several of its feet, and use of United States territory is indispensable to it. The location of facilities in some foreign countries is also essential to the plan, but the selection of any single other country is, apparently, not essential. Any one such country could readily be abandoned for another.

Therefore, it is concluded that the above stated patent claims have been infringed. The plaintiff is entitled to recover and judgment is entered to that effect.

The opinion, as modified, findings of fact, and conclusion of law of the trial judge follow.

OPINION OF TRIAL JUDGE

COOPER, *Trial Judge:* Alleging that the world-wide Omega navigation system sponsored by the United States is an infringement of claims 1, 4 and 11 of its O'Brien et al. Patent No. 2,844,816, plaintiff brings this action for reasonable compensation under 28 U.S.C. § 1498. Defendant resists the claim, contending that the patent is invalid because the disclosed embodiment is inoperative and because the disclosure does not meet the requirements of 35 U.S.C. § 112.[1]

[1] Defendant makes no contention that the claims are invalid under either 35 U.S.C. § 102 or § 103, having expressly waived those defenses.

In addition, defendant maintains that the Omega system is not covered by any of the claims here in issue. Finally, to the extent that the case for infringement is based on equipment located in foreign countries, defendant maintains that the patent laws of the United States and, hence, 28 U.S.C. § 1498, extend only to the territorial limits of the United States and preclude recovery based on equipment in such countries.

For the reasons stated hereinafter, it is concluded that plaintiff has carried its burden of proving infringement of claims 1, 4 and 11. It is further concluded that defendant has not established invalidity of the patent on the grounds asserted, and that the extraterritorial issue raised by defendant does not preclude a finding of liability in this case.

I

The technology here in issue relates to hyperbolic radio navigation systems wherein separate transmitting stations fixed at known locations send out radio signals that are sensed by a mobile receiver at a position remote from the transmitters. In hyperbolic navigation, the receiver measures the time difference in arrival of the radio signals, the time difference being a measure of the difference between the distances traveled by the signals. In this way, a line of position (LOP) on which the receiver is located can be identified. The system is referred to as hyperbolic because the lines of position, as shown on a navigation chart, are in the form of hyperbolas. These hyperbolic LOPs are described as the path traced by a point moved in such a way that the distances between it and each of a given pair of transmitters always differ by a constant.

In hyperbolic navigation, signals from at least three stations are necessary, the signals from one pair of the stations being used to identify one LOP and the signals from another pair of the stations identifying another LOP. The intersection of the two LOPs provides a position fix which pinpoints the receiver's location.

On hyperbolic navigation charts, adjacent hyperbolic lines define between them a zone or lane. If the radio signals from two stations are received exactly in phase with each other,

this indicates that the receiver is on one of the hyperbolic lines. If however, the signals are out of phase, this indicates that the receiver is in between the hyperbolic lines, *i.e.*, in one of the lanes. The problem with which both the '816 patent and the Omega navigation system are concerned is one of ascertaining which of the lanes the receiver is in and where it is in that lane.

In the '816 patent, the width of the larger zones or lanes was chosen to correspond to 1f, *i.e.*, one hyperbolic line of position is separated from the next adjacent line by one-half cycle of the fundamental frequency. If, as is the case with the accused Omega system, the 1f frequency is 1.133 khz., the basic lane width, as measured on the base line between two stations, is 72 nautical miles.[2] Since hyperbolic navigation charts are conventionally based on 9f, at that frequency, the lane width is 8 nautical miles. Hence, the problem of lane identification is one of determining which 8-mile-wide lane the vehicle carrying the receiver is in and, also, where it is in that 8-mile-wide lane.

The '816 patent, and in particular, the embodiment of Figures 4, 5 and 7 thereof, proceeds on the assumption that the navigator knows where he is within ±36 miles, that is, that he knows which group of nine 8-mile-wide lanes he is in but not where he is in that group. To resolve that problem, the '816 patent proposes to use signals of 9f, 10f and 12f sent from each of two transmitting stations A and B, the signals from each of the stations being transmitted in phase with each other. The transmission pattern of the signals is distinctively altered periodically so that the receiver can tell which of the stations it is receiving at any given time. At the receiver, the phase values of the 9f signals from stations A and B are stored and compared. The difference in phase of these two signals is proportional to the difference in time of propagation, and is indicative of the position of the receiver in a 9f lane. In other words, by phase comparing the two 9f signals, the receiver provides a readout, referred to in the

[2] Lane width may be expressed in various ways. Stating it in nautical miles always requires specifying the frequency and an understanding that the measurement is "on the base line." As used herein, reference to nautical miles (n.m.) is to be understood to refer to a measurement on the base line.

patent as the "fine" control, which tells the navigator where he is in a lane 8 miles wide.

It will be appreciated that this still leaves the question of which 8-mile lane the receiver is in. To resolve that problem, the receiver of Figure 7 uses ÷3 dividers and mixers to develop a 1f signal from each of the two stations. This is accomplished, as to each station, by "beating" or subtracting the 9f and 12f signals to obtain a difference frequency or 3f beat signal, which notches a divider to produce from the original 9f signal a 3f output in phase with that original signal. Then, by beating the 9f and 10f signals to obtain a 1f difference signal, a second set of ÷3 dividers is notched to produce from the 3f signal a 1f signal which carries the same phase as the original 9f. This is performed in two separate channels of the receiver, one channel processing the signals from station A and another channel processing the signals from station B. The two 1f signals thus produced from stations A and B are then phase compared and the phase difference is reflected in what the patent terms a "coarse" control. The coarse control indicates the position of the receiver in a 1f lane, *i.e.*, a lane 72 miles wide or, stated otherwise, a group of nine 8-mile-wide lanes.

Taking the two readouts together, the navigator is provided with a LOP which tells him which lane out of a group of nine lanes he is in and where he is in that particular lane. To establish a position fix, the '816 patent proposes a third station C which will provide a third set of 9f, 10f and 12f signals, and these signals are processed in a third channel of the receiver. Thus, the signals from stations A and B, when processed as described, will provide one LOP and the signals from stations A and C will establish a second LOP. Where the two LOPs cross, the position of the receiver is established.

At this point, and before discussing the Omega system, it is well to consider defendant's contentions concerning the invalidity of the patent. Defendant contends that the readouts from the '816 receiver are meaningless because they could refer to any one of an infinite number of hyberbolic isophase lanes. Further, it is contended that the action of the mixers and dividers destroys the phase integrity of the

signals in the receiver and, lastly, that the transmitters disclosed in the patent are incapable of producing a stable pattern.

Defendant's evidence in support of these defenses is not persuasive and none of these contentions can be sustained. There is no doubt that the '816 receiver is limited in its lane resolution capability to an unknown of ± 36 miles. But so is the Omega system yet to be described. The important point is that the '816 patent does disclose a system which, within its defined limits, is operative to resolve lane ambiguity. The mere fact that the system has some drawbacks, or that under certain postulated conditions it may not work, or that better, more sophisticated, equipment has been developed which does a better job does not detract from the operability of the disclosed equipment to perform its described function.

Nor does the fact that in the "real world" radio waves are subjected to a variety of disturbances and aberrations alter this conclusion. As described in finding 8, the '816 receiver does provide some compensation for these aberrations and it is in response to this very problem that the patentees suggested using the three frequencies 9f, 10f and 12f. With these three frequencies, the patentees found they could cope with about three times the perturbation as with only two frequencies.

Quite clearly, inoperativeness is not established merely by showing that the particular disclosed embodiment for carrying out the principles of the invention is lacking in perfection. *Field* v. *Knowles*, 183 F. 2d 593 (CCPA 1950). In this respect, it is worthy of note that a "raw" LOP, that is, one in which there has been no correction for the aberrations and unwanted effects encountered by the radio waves, still has utility for rendezvous purposes and it is precisely for this purpose that the accused Omega system was designed to have the capability of producing similar readouts.

Nor is there merit in defendant's contentions respecting inadequacy of the disclosure. Based on the record in this case, there is no doubt that one of ordinary skill in the art would be able to understand the patent disclosure and, from that disclosure, using the skill of the art, could build an operative system. That is enough to satisfy the requirements of 35

U.S.C. § 112. *Bowser, Inc.* v. *United States*, 181 Ct. Cl. 834, 388 F. 2d 346 (1967); *Trio Process Corp.* v. *L. Goldstein's Sons*, 461 F. 2d 66, 74 (3d Cir. 1972), *cert. denied*, 409 U.S. 997.

Accordingly, it is concluded that claims 1, 4 and 11 are valid.

II

Considering now the accused Omega system, it is a very low frequency (VLF) radio navigation system in which eight transmitters are to be located at strategic locations around the world. At the present time, only three stations have been completed, two in the United States (Haiku, Hawaii, and La Moure, North Dakota) and one in Norway. When the system is completed, signals from these eight stations will provide all-weather navigational service throughout the world.

The hyperbolic radio navigation technique is basic to the Omega system; however, the system is designed to have capabilities beyond that. For example, a navigator equipped with a suitable receiver can also employ rho-rho (or range-range) navigation. This latter type of navigation employs a circular grid, instead of hyperbolic, and requires signals from only one station. Nonetheless, it is clear that both of the receivers accused to infringe, the AN/ARN-99 for surface and aircraft, and the AN/BRN-7 for submarines, use the hyperbolic mode for establishing an initial position. The ARN-99 can then go to a rho-rho mode but the BRN-7 remains at all times in the hyperbolic mode. In addition, both receivers have the capability to display, at any time, a "raw" hyperbolic LOP. Since the '816 patent is concerned only with hyperbolic navigation, the accused system will only be considered from that standpoint, it being recognized that the rho-rho capability is an additional feature of the ARN-99.

The Omega system is designed to use the latest, most modern and sophisticated equipment. At the Omega transmitters, atomic clocks in the form of cesuim beam standards are used to coordinate the transmissions from each station and to ensure that all stations are in synchronism with each other. Each station transmits signals of 9f, 10f and 12f in a

distinctively altered pattern so that the receiver is able to determine which station it is receiving and to synchronize itself with the incoming radio waves.

Each receiver consists of a three-channel radio receiving section and a computer section. The computer is a militarized general purpose digital computer that has been preprogrammed for Omega navigation. The navigator cannot change the program in the computer or, in any way, alter the routine of the computer. The radio receiver section consists of amplifiers, mixers and other component hardware by which the incoming 9f, 10f and 12f signals may be processed and converted to digital information which the computer can handle. This is done in each channel of the receiver by beating each of the incoming 9f, 10f and 12f signals against the output of a local oscillator to produce three separate intermediate frequencies (If), each of which carries the phase information of the respective 9f, 10f and 12f signals. This phase information is then converted into a series of electrical pulses representing binary digits that are fed into the computer section and stored in the memory core.

As with the '816 patent, the Omega receiver is able to determine its initial position only within ±36 miles when it operates in the hyperbolic mode. In other words, the navigator must know which 72-mile-wide lane he is in and the receiver will then be able to determine, by a laning procedure, which of nine 8-mile-wide lanes it is in and where it is in that particular 8-mile-wide lane. That is achieved in the following manner, it being recognized that the described functions are actually performed by the computer through a process of "state vector" analysis to arrive at a determination of which 8-mile-wide lane the receiver is in. The 9f, 10f and 12f frequencies are "differenced," that is, the 9f and 10f signals from each of two stations are subtracted to develop a difference frequency of 9f, the 9f and 12f signals are subtracted to arrive at a 3f and the 10f and 12f signals are subtracted to arrive at a 2f. With a fundamental frequency of 1.133 khz., the basic frequencies of 9f, 10f and 12f define lanes 8, 7.2 and 6 miles wide, respectively, while the difference frequencies of 1f, 2f and 3f define hyperbolic lanes of 72 miles, 36 miles and 24 miles, respectively. The computer uses

its stored phase information to make a phase comparison of the signals from the two stations at these difference frequencies to establish a position in the larger lanes. By using three frequencies, ambiguities in the position in the lane are resolved. The speed of the digital computer is such that it can difference the frequencies and make the phase comparisons a number of times in a matter of seconds. It then averages the results of its computations and arrives at a best estimate or determination of which 8-mile-wide lane it is in.

Having made that determination, the computer then switches from the difference frequency mode to the single frequency mode. In this mode, it compares the phase of a single frequency from each of two stations. For example, it will make a phase comparison of the 9f signals from stations A and B and since that frequency defines an 8-mile-wide lane, the phase difference is indicative of where the receiver is in the 8-mile-wide lane previously identified. Here again, the speed of the computer is such that it can perform the operation a number of times and average the results within seconds before producing a readout.

Once the receiver has established its position, it can then simply count the hyperbolic lanes as it crosses each one. If, at any time, the operator wants to know his position, the receiver will, on command, display a "raw" hyperbolic LOP. That LOP consists of the current lane count, *i.e.*, the number of the 8-mile-wide lane which the receiver is in, and, by a phase comparison of the 9f signals as described above, a digital display of how far across that lane the receiver has progressed as of that moment. The accused receivers have the further capability to apply various programmed corrections to their calculations and to convert position determinations to a readout expressed in latitude and longitude.

III

Turning to the issue of infringement, claim 1 is as follows:

> A hyperbolic radio navigation system in which a position line is determined by indicating the difference in the time of propagation to a receiver of signals emitted from two stations in known spaced geographical positions, wherein three signals are emitted from a first sta-

tion satisfying the respective phase conditions, given in radians of angle, $n_1\omega_o t+a_1$, $n_2\omega_o t+a_2$ and $(n_1+1)\omega_o t+a_3$, and three signals are emitted from the second station satisfying the respective phase conditions $n_1\omega_o t+a_1+k$, $n_2\omega_o t+a_2+k$ and $(n_1+1)\omega_o t+a_3+k$, where n_1 and n_2 are integers, ω_o is 2π multiplied by a fundamental frequency in cycles per second, t is time in seconds and a_1, a_2, a_3 and k are constants, the transmissions being switched in sequence such that the signals of each frequency are transmitted from one station during intervals of the transmissions of the same frequency from the other station, and the transmission being distinctively altered periodically for synchronising switching means at the receiver with the switching of the transmissions and wherein the receiver comprises means for receiving the radiated signals, switching means which are synchronised by the distinctive alteration in transmission and which are arranged to separate the received signals from the two transmitters, and a phase difference indicator for indicating the difference in time of propagation which indicator has a recurrence cycle of time difference indication equal, in seconds, to the reciprocal of the fundamental frequency, said indicator being operated by a fine control and a coarse control, said fine control being dependent on a pair of signals derived from locally generated non-interrupted signals, one of which is phase-controlled by only one of the signals received from said first station and the other by only one of the signals received from said second station and the coarse control being dependent on six received signals derived from the three different frequencies transmitted from each of the stations.

Defendant correctly urges that more than a literal response to the terms of this claim must be shown for plaintiff to make out a case of infringement. *Westinghouse* v. *Boyden Power Brake Co.*, 170 U.S. 537, 568 (1898). Not only must that be demonstrated, but it must also be shown that the accused system does substantially the same work in substantially the same way to accomplish substantially the same result as the claimed system. *Marvin Glass & Associates* v. *Sears, Roebuck & Co.*, 448 F. 2d 60 (5th Cir. 1971); *Dominion Magnesium Ltd.* v. *United States*, 162 Ct. Cl. 240, 320 F. 2d 388 (1963).

With respect to the literal readability of claim 1 on the Omega system, this is set out in finding 19 and no useful purpose is served in repeating it here. Suffice to say that plaintiff

has sustained its burden of showing, by a preponderance of the evidence, that the Omega system, with two transmitters such as those at Haiku and La Moure and with either the ARN–99 or the BRN–7 receivers, does respond to the literal language of claim 1.

Notwithstanding literal readability, defendant maintains that the Omega system does not employ substantially the same means to provide the same end result. In particular, defendant relies on the fact that a general purpose digital computer is used in Omega as compared to the analog arrangement disclosed in the patent; that the computer is of a type used for many other purposes; that it is the computer software that actually performs the calculations from which lane identification is made and that this software is nothing more than a set of equations; and that the Omega receivers are capable of doing far more than the receiver disclosed in Figure 7 of the '816 patent.

Of course, the mere fact that one or more elements of an accused combination, in this case the computer, are susceptible of noninfringing uses does not mean that all systems employing those same elements avoid infringement. *LaSalle Street Press* v. *McCormick & Henderson, Inc.*, 445 F. 2d 84, 94 (7th Cir. 1971). Hence, the testimony that the same general purpose computers are used in noninfringing systems employed on bombing missions is utterly irrelevant to the question of whether the computer, when combined with the other elements of the Omega system, infringes the navigational system of claim 1.

With respect to the contention that defendant's use of digital means distinguishes the accused system, it is to be noted that the claim is not, by its terms, in any way limited to the specific analog mechanism disclosed. Also, the specification contains no indication that it was the configuration or details of the particular apparatus disclosed that was considered by the patentees to be their invention. Indeed, as it is stated at col. 7, lines 4–6 of the patent, "there are many ways of constructing a receiver to give identical or equivalent information" to that achieved with the receiver shown in Figure 7. Nor is there either prior art which requires that the claims be limited to the apparatus disclosed in order to

preserve its validity, or proof that the doctrine of file wrapper estoppel requires such a limited construction of the claim. In short, the evidence supports the conclusion that it was a system which included a receiver capable of performing the functions of sychronizing itself with the transmitted signals, separating the signals, and producing from those signals a fine and coarse readout that was the invention, not the specific mechanism by which the receiver achieved those results. On these facts, infringement is not avoided by showing that digital instead of analog techniques are used in the accused system. *National Dairy Products Corp.* v. *Swiss Colony, Inc.*, 364 F. Supp. 134, 152 (W.D. Wis. 1972).

Nor are defendant's arguments regarding the software any more persuasive. While *Gottschalk* v. *Benson*, 409 U.S. 63 (1972) held that computer programs were not patentable per se, claim 1 is clearly directed to a combination of elements and not just to a program. Nor does claim 1, as applied to Omega, read only on the program in the computer. Indeed, as defendant's expert testified at trial, the program accomplishes nothing by itself; it must be mechanized to achieve the navigational functions for which the Omega system is designed. Thus, defendant's argument that the burst filter, the tracking filter and the Kalman filter by which the Omega computer processes the data are "mere abstractions" having no "physical" existence is entirely beside the point. The theory on which, for example, the Kalman filter, is based, and the instructions or program for the computer itself, may be nothing more than a set of equations, but the means for receiving the signals and processing them and the means for performing those instructions and achieving the end result quite clearly have a tangible, physical existence which meets the terms of the claim.

Nor can any weight be given to defendant's arguments regarding the sophistication of Omega as compared to the '816 embodiment. As defendant points out, digital computers were not really available in 1954 and the Kalman filtering process was not even developed until 1960. And there is no doubt that the Omega system, with atomic clocks and computerized operation, is able to provide for more accurate readouts of position than would have been achieved with the

embodiment of Figure 7 in the patent. However, merely because the accused system is an improvement over the patented system does not mean that it does not also infringe the patent. *Eastern Rotorcraft Corp.* v. *United States*, 184 Ct. Cl. 709, 397 F. 2d 978 (1968).

What is controlling here is that the Omega system, when operating in the hyperbolic mode, uses the basic system that was the contribution of the patentees in the '816 patent. Thus, 9f, 10f and 12f signals are radiated in phase in a distinctively altered pattern and sequentially switched from two spaced transmitters; the distinctive pattern of the transmissions is used to synchronize the receiver with the sequence of the transmission; the signals are received and they are separated into separate processing channels; an indicator in the form of an LOP readout is provided, with the readout displaying a "coarse" position and a "fine" position; the fine position is dependent on the received and stored 9f signals and a phase comparison of those two signals; and the coarse position is obtained by frequency differencing the 9f, 10f and 12f from each of the two stations and a phase comparison of those signals. That is the system defined by claim 1, that is the patentees' contribution as defined by that claim and that is how Omega works. Having shown that by a preponderance of the evidence, plaintiff has met its burden. *Stamicarbon, N.V.* v. *Escambia Chem. Corp.*, 430 F. 2d 920 (5th Cir. 1970), *cert. denied*, 400 U.S. 944.

Claim 4 is dependent on claim 1 and merely adds the requirement that the signals be radiated in sequence. Omega clearly does so, and for the same purpose, as in the '816 patent.

Claim 11, the only remaining claim asserted here, adds the limitation of a third transmitting station radiating signals satisfying certain specified phase conditions vis-a-vis the signals from the other two stations. The outputs from these three stations, taken in pairs, permit development of two intersecting lines of position and, therefore, a position fix for the receiver. For the same reasons as were discussed in connection with claim 1, it is concluded that the accused Omega system has a third station radiating signals as de-

scribed and that the receiver can and does operate in the manner claimed.

Defendant, however, points out that the only station other than those located at Haiku, Hawaii, and La Moure, North Dakota, is in Norway and, hence, outside the territorial limits of the United States. Citing *Deepsouth Packing Co.* v. *Laitram Corp.*, 406 U.S. 518 (1972), defendant asserts that a claim is infringed only when an operative assembly of the entire claimed combination is made or used within the territorial limits of the United States. Defendant would have the court hold that since the third station required by the combination is in Norway plaintiff cannot show that the combination, as an operable assembly, was either made or used entirely within the territorial limits of the United States and that, therefore, there can be no liability under claim 11.

However, plaintiff is correct that *Deepsouth* really is not in point since that case dealt with a situation where the operative assembly of the claimed combination was completed and used wholly outside the United States. Here, only a portion of the claimed combination, one transmitter out of the requisite three, is located outside the United States while the beneficial use of the completed assembly actually occurs within the jurisdiction of the United States, when either a vessel or an airplane equipped with an Omega receiver and owned by the defendant receives and utilizes the signals in the manner claimed. Also, in *Deepsouth*, by the time the combination was assembled, all the elements of the combination had been sold and were in the hands of someone other than the domestic manufacturer. Here, all of the equipment in Norway was purchased by the United States, installed by the United States, continues to be owned by the United States, was operated initially by the United States and it operates today for the benefit of the United States under the direction and control of the United States. On these facts, *Deepsouth* cannot be considered to be controlling here.

The question thus presented is whether the system of claim 11 has been made or used, as those terms are employed in the patent law, by or for the United States. Stated more factually, the issue is whether, despite the third station being located on sovereign Norway soil, the United States can be

said to have either made or used the claimed system in the United States.

Neither party has cited any cases dealing with the precise question presented and it appears to be one of first impression. Plaintiff suggests that some guidance can be derived from tort principles since patent infringement is a technical tort. In particular, plaintiff contends that, on the issue of which law to apply, the traditional rule is that a tort occurs when it is completed, where the last act occurs, even if part of the action leading up to it takes place elsewhere, or where the injury is sustained. Under that analysis, plaintiff urges that the tort of infringement was completed, and the injury sustained, when the receiver in the United States received the signals from all three transmitters. Accordingly, plaintiff urges that the infringement occurs in the United States. However, as defendant points out, it is settled that Governmental use of a patented invention is viewed as an eminent domain taking of a license under the patent and not as a tort, *Crozier* v. *Krupp*, 224 U.S. 290, 308 (1912), so the tort analogy is imperfect at best. Yet an analytical approach based on an eminent domain theory produces results similar to plaintiff's tort analysis. From the standpoint of a "use" by the United States, a cause of action under § 1498 arises when the accused equipment is first available for use, *Regent Jack Mfg. Co.* v. *United States*, 167 Ct. Cl. 815, 337 F. 2d 649 (1964), and it is when the use occurs that a license is considered to have been taken. *Irving Air Chute Co.* v. *United States*, 117 Ct. Cl. 799, 93 F. Supp. 633 (1950). It is this taking of a license, without compensation, that is, under an eminent domain theory, the basis for a suit under § 1498. Here, it is when the receiver receives the signal in the United States that there is a completed use of the system. From a tort viewpoint, that is when the "injury" is sustained and from an eminent domain analysis that is when the license is taken.

Neither analytical approach, however, leads inexorably to a conclusion that claim 11 has been infringed. The plain fact is that one of the claimed elements is outside of the United States so that the combination, as an operable assembly, simply is not to be found solely within the territorial limits

of this country. But there is no doubt that, to the extent possible, the system was made in the United States. By its very nature, the system has to have transmitters located outside of the territorial boundaries of this country, and it is necessary in installing those foreign transmitters to construct certain aspects, *e.g.*, the radiating antenna and the helix coil, on site. It is also worth noting that the final steps to achieving an operable assembly of the system as a whole took place in the United States. Thus, before the Norwegian station could transmit, it had to be synchronized with the United States stations. This was accomplished by flying an atomic clock from North Dakota to Norway and, by using the epoch pulse of the clock, the Norwegian station was placed in phase with the United States stations. Then the atomic clock was flown back to the United States to be checked for any impermissible drift. It was only at this point that the three transmitters could be said to be an operable assembly radiating signals in the required phase relationship. Finally, the last element and the final link in a complete and operative system, a receiver having a phase difference indicator actually receiving and processing signals in the manner claimed, is in the United States.

Analyzed from the standpoint of a use instead of a making by the United States, a somewhat clearer picture emerges. The transmission from the Norwegian station is controlled by the United States in the sense that it established and continuously monitors the signals from that station, and this all occurs in the United States. In addition, defendant established through the use of atomic clocks, as previously described, the necessary synchronization of that station and part of that activity occurred in this country. Further, it is from the United States all actions are taken to ensure synchronization of the transmissions of that station with those in the United States. In other words, it is obvious that, although the Norwegian station is located on Norwegian soil, a navigator employing signals from that station is, in fact, "using" that station and such use occurs wherever the signals are received and used in the manner claimed.

In view of the foregoing, and while the matter is not free from doubt, it is concluded that a basis for liability under claim 11 has been shown. This conclusion does not rest on any one factor but on the combination of circumstances here present, with particular emphasis on the ownership of the equipment by the United States, the control of the equipment from the United States and on the actual beneficial use of the system within the United States. In addition, one other consideration that should be mentioned is that it is clear from both the specification of the patent and the claim that the patentees' contribution was not in the manner by which a transmitter generated and radiated the signals, but rather it was in a system in which signals having a particular relationship were received from spaced sources and utilized in the receiver to arrive at a position fix. Had it been otherwise, that is, had the invention dealt with the generation of the signals themselves, it seems clear that utilization of those signals in this country would only have been incidental and that operation of the Norwegian station would have been beyond the reach of the U.S. patent laws. As it is, the result reached is believed to be consistent with the patentees' true contribution and serves to secure to them their just reward for that contribution.

Finally, in treating the extraterritorial issue, the parties have included all of the transmitting stations in their arguments. However, the one in Norway is the only one that need be considered to resolve the question of liability under claim 11. What the situation may be, either with respect to the other stations or the equipment purchased by the defendant but not yet installed, is a matter properly to be considered in the accounting, should it be relevant.

In conclusion, claims 1, 4 and 11 are valid and infringed and plaintiff is entitled to recover reasonable and entire compensation.

FINDINGS OF FACT

1. Patent No. 2,844,816, entitled "Radio Navigation Systems" issued July 22, 1958, on an application Serial No.

492,592 filed on March 7, 1955, by William J. O'Brien and Harold G. Hawker. Priority is claimed on the basis of an application filed in Great Britain on March 8, 1954. Ownership of the patent rests in plaintiff, a corporate subject of England, domiciled in London, England. Claims 1, 4 and 11 are the only claims in issue.

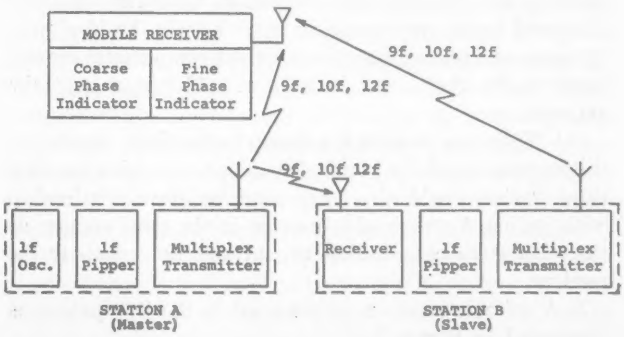
2. The patent in suit, herein referred to as the '816, relates to a system of radio navigation in which a plurality of transmitters transmit(s) a sequence of segments of continuous-wave (CW) radio signals, employing three specific, harmonically related frequencies, to be received on the "vehicle to be navigated," adapted to receive the signals separately and process them so as to determine the vehicle's navigational position by making a phase comparison of signals. The invention is particularly concerned with hyperbolic radio navigation systems in which separate transmitting stations fixed at known locations send out radio signals which are sensed by a mobile receiver at a position remote from the transmitters. The mobile receiver measures the time difference in arrival of the radio signals, the time difference being a measure of the difference between the distances traveled by the signals. In this way, a line of position (LOP) on which the receiver is located is identified. The system is referred to as hyperbolic because the lines of position are in the form of hyperbolas. Such a hyperbolic LOP would be the path traced by a point which moved in such a way that the distances between it and each of a given pair of transmitters always differ by a constant. By establishing a second line of position based on signals from a second pair of stations, the intersection of the two provides a position fix which pinpoints the receiver's location.

3. (a) The particular problem to which the '816 patent is directed is what is known as "lane resolution" or "lane identification." In a hyperbolic system, adjacent hyperbolic lines define between them a zone or lane. Lane identification is concerned with the problem of finding which lane or zone the receiver is in out of a group of lanes. In the '816 patent,

the width of the larger zone or lane was chosen to correspond to 1f, *i.e.*, one hyperbolic line of position is separated from the next adjacent line by one-half cycle of the fundamental frequency. This zone width can be expressed in various ways. Stating it in nautical miles always requires specifying the frequency and an understanding that the measurement is "on the base line" because hyperbolic lanes widen as they separate from the base line drawn between two radiating stations. A more accurate and generic way to define it is to employ units which depend on phase difference because such a definition is accurate regardless of where the receiver is relative to the base line. Since the difference in phase of the two signals is actually proportional to the difference in time of propagation, albeit in different units, the 1f lane can be expressed as a time difference indication rather than a phase difference.

(b) If, as is the case with the accused Omega system, the 1f frequency is 1.133 khz., the basic lane width, as measured on the base line, is 72 nautical miles. At a frequency of 9f, the lane width is 8 nautical miles. Hyperbolic navigation charts are conventionally based on 9f so the problem of lane identification is one of not only determining which 8-mile lane the vehicle is in but also where it is in that 8-mile lane.

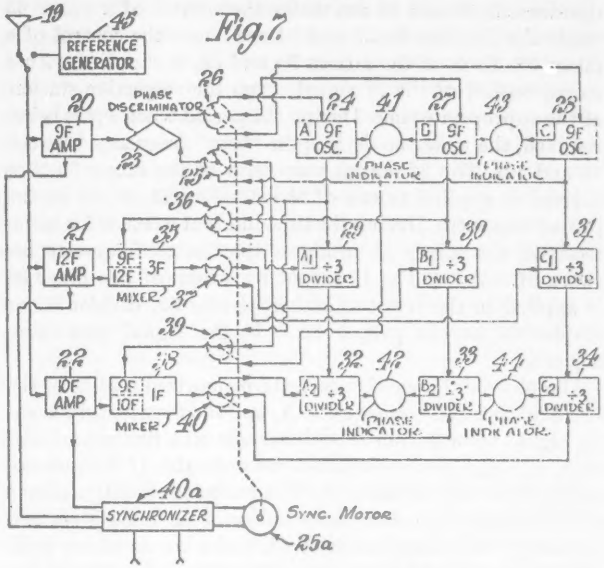
4. (a) The basic system contemplated by the patent is, in block diagram form, as follows:



(b) The patented system contemplates at least two stations, A and B. The transmitters of both stations are identical except that, to ensure synchronized radiation of their signals, the operation of station B is controlled, in a master/slave relationship, by station A. The transmitter produces output signals of 9f, 12f and 10f, by generating higher integral harmonics of a low basic fundamental frequency. A conventional audio oscillator constructed to generate a sinewave output signal of the fundamental frequency 1f, is connected to drive or actuate a 1f "Pipper." The pipper generates a repetitive wave train comprised of a series of very short, narrow pulses. These pulses, which are very rich in harmonic content, contain essentially all of the odd and even harmonics of the 1f input signal. The transmitter also includes three very sharply tuned amplifiers, and these are used to extract the 12f, 10f and 9f harmonics, respectively, from the spectrum of frequencies which appears at the output of the 1f pipper. The output of the power amplifiers is commutated out onto the antenna by means of a rotary switch provided with a rotor element which is driven by a synchronous motor. The rotory switch includes a set of conductive arcuate segments, each of which is sequentially engaged by the spinning rotor of the switch. As the rotor successively engages the arcuate conductive segments tied to respective power amplifiers, the harmonic signal thus received is applied to the antenna. The phase of the outgoing 12f, 10f and 9f harmonic signals is compared to the corresponding outputs from the 1f pipper, by means of a phase discriminator which compensates for any phase shifts that occur between the 1f pipper and the antenna.

(c) While two stations are shown in the block diagram, a third station would be required to obtain a position fix. This third station would also be in a master/slave relationship with station A and would function in the same manner as the other stations to radiate 9f, 10f and 12f signals to the receiver.

5. A suitable receiver, as disclosed in the '816 patent, is illustrated in Figure 7:



The receiver system takes the form of a three-channel configuration in which transmitted signals of 9f, 10f and 12f are received. Incoming signals of 9f which successively impinge upon the antenna 19, are commutated into 9f memory oscillators 24, 27 and 28. Each of these memory oscillators "memorizes" the phase of the incoming signal from a given station, as a result of the action of a phase discriminator 23. The discriminator 23 effectively phase-locks each oscillator respectively to the instantaneous phase of the incoming burst of 9f. By this means, a stored replica of the phase of the incoming carrier frequency from each of the three stations is retained, and available for signal processing after the transmission interval for the respective burst of 9f has ended.

The 9f signals generated by the memory oscillator in each vertical tier are first applied to dividers 29, 30 and 31 to obtain a 3f signal and then to another set of dividers, 32, 33 and 34, respectively, to derive a signal of frequency 1f. The

dividers 29, 30 and 31 are under the control of a mixer 35 while the dividers 32, 33 and 34 are under the control of a mixer 38. Each of the mixers 35 and 38, is supplied with a stored replica of the 9f signal, from the respective station, at the appropriate time. During the period when 12f is being received, the mixer 35 derives the "beat" frequency between 9f and 12f. The 3f output waveform of the mixer 35 thus derived is applied to one of the dividers 29, 30, 31 in the proper sequences. During the time interval when 10f is being received, the mixer 38 produces the "beat" frequency between 9f and 10f. The 1f output waveform of the mixer 38 is applied to the input of either divider 32, divider 33 or divider 34 at the proper time in the signal processing sequence.

The phase difference between the memorized replica of the 9f signal received from station A, and the memorized incoming signal from station B is observable on a fine phase indicator 41. The phase difference between the 1f frequencies developed by the dividers 32, 33 is rendered visually observable by means of a coarse phase indicator 42. The system also includes a fine phase indicator 43, and a coarse phase indicator 44, connected between two other adjacent vertical channels in the receiver.

The incoming 9f signals from the three stations arrive at the receiver in sequence. As a result, means must be provided for commutating the incoming 9f signals into the particular memory oscillator intended to process signals from a specific station. As shown, oscillator 24 must always receive and memorize the phase of the burst of 9f arriving from station A, oscillator 27 must sense and store the phase of the incoming burst from station B, and oscillator 28 must sample and phase-lock to the phase value associated with the incoming carrier burst of 9f arriving from station C. In order to commutate the sequentially arriving 9f signals into the correct oscillator, the system employs a rotary switch 26 which takes the form of a conductive rotor sequentially engaging three conductive arc segments. Each of the conductive arc segments is connected to the input of one of the 9f memory oscillators, in order to permit the spinning rotor to apply each of the incoming 9f signals to the appropriate memory

oscillator. The rotor element of switch 26 is mechanically ganged to the rotor elements in a number of other switches. One of these switches is used to commutate the output signal from the mixer 35 into the dividers 29, 30 and 31 during the correct time interval in the signal processing cycle period. The output signal from the mixer 38 is also commutated either into divider 32, 33 or 34 as required, by means of one of the switches which is ganged to the rotor of the switch 26. The position of the spinning rotor must be synchronized at all times with that of a spinning rotor which is employed at the shore stations (*i.e.*, transmitters) to commutate 9f, 12f and 10f signals out onto the air. This is accomplished by a synchronizer 40a and a synchronous motor 25a, which act to ensure that the receiver and the transmitter are always precisely correlated.

6. The receiver shown in Figure 7 utilizes frequencies of 9f, 10f and 12f. Assuming a fundamental frequency of 1.133 khz, the basic navigation frequencies are 10.2, 13.6 and 11⅓ khz. Using these frequency values, the memory oscillators 24, 27 in the first two vertical tiers of the receiver are both memorizing the phase of incoming 10.2 khz. signals. The fine phase indicator 41 will provide an indication of the phase difference between the two incoming 10.2 khz. sinusoidal signals. The frequency of the output signals produced by the first divider in each tier will be 3.4 khz. A phase indicator connected between these two dividers 29, 30 would read the phase difference between the two 3.4 khz. sinusoidal analog waveforms. The lowermost dividers 32, 33 supply input signals of 1.133 khz. to opposite sides of a coarse phase indicator 42.

The readout on coarse phase indicator 42 corresponding to the 1.133 khz. wave length would represent a position in a 72-mile-wide lane. The indications which appear on the phase indicator 42 are nine times "coarser" than those which appear on the fine phase meter 41. The values which appear on coarse phase meter 42 are indicative of a position in a 72-mile-wide lane on a hyperbolic grid, and those of fine phase meter 41 are indicative of a position in an 8-mile-wide lane. Together, the meter 42 identifies which of nine lanes, each 8 miles wide, the receiver is in and meter 41 indicates the position within the particular 8-mile-wide lane.

7. VLF energy radiated out to a remote receiver is susceptible to many variations between the time it leaves the transmitter and the time it is received at the receiver. Such things as earth surface conductivity, diurnal variations and many other factors which vary from place to place over the earth's surface will have an effect on a radio wave. In addition, aberrations of unknown origin and unpredictable duration are also encountered and either effect the radio wave or may interfere with any reception of the signal. As a result, although signals may be phase-locked when transmitted, they may be out of phase due to factors other than the time difference of propagation by the time they are received.

8. (a) The '816 system has a limited capability to provide lane identification in the presence of noise and propagation error. It does so in the following manner. The 9f signals are fed respectively to the phase-locked oscillators 24, 27 and 28. These oscillators are driven by the incoming 9f signals and, therefore, they effectively "track" the 9f both as to frequency and phase, and, since their output is a clean, "noise free" signal, they are referred to as "tracking filters." Adequate tracking filters, such as oscillators 24, 27 and 28, were known in 1954 and were capable of producing relatively clean signals. The fine control is then obtained by phase-comparing these signals at meters 41 and 43. The coarse lane identification is accomplished by two stages of controlled ÷3 division as follows. Referring first to signals from the A station by itself, the 9f output from oscillator 24 is divided by 3, by divider 29, and again by 3, by divider 32. The outputs of dividers 29 and 32, however, would be ambiguous if they were not further controlled. Thus, the divider 29 can be driven by any one of each third cycle of oscillator 24, and divider 32 can be driven by any one of each third cycle of divider 29, and without further control the precise cycle which is to do the driving is arbitrary. The way it is controlled in the '816 is first by developing a 3f signal from beating the 9f and 12f signals from station A at mixer 35. The 9f used for this is the output of the oscillator 24 which, in effect, is a stored representation of the 9f from station A. The 12f used is the 12f output of amplifier 21.

(b) The developed 3f beat signal is injected into the divider, and comprises an overriding or "notching" 3f signal which can effectively cause the 3f output to move over so as to receive its driving force from a different cycle of each group of pulses of the train. This shifting, however, will not take place unless the injected 3f signal is more than 60° out of phase with the previously existing 3f output (or 180° out of phase with the 9f). If the injected 3f is 60° or less out of phase, after the injected 3f goes off, the divider will move back and resume its alignment with the same cycle of the 9f group as before, just as though the 3f signal had never been injected.

(c) The same thing happens in the next division from 3f to 1f. Thus, if an overriding or "notching" 1f signal is injected into the divider (*e.g.*, divider 32) which is more than 60° out of phase with the existing 1f output of the divider (or 180° out of phase with the 3f), the divider will move over so as to be driven by a new one of the 3f pulses. And if the injected 1f is 60° or less out of phase, the 1f divider will move back and resume its alignment with the same 3f pulse it was on before.

(d) In this way the dividers 29, 30, 31, 32, 33 and 34 are controlled or "notched" under the influence of all three transmission frequencies from each station to cause the coarse phase indicators 42 and 44 to be driven in correspondence with a given notch of the 9f, thereby permitting the coarse meters to be calibrated so as to read out the whole number of the lane. Once the "notching" is correctly established, the dividers effectively store the lane information for periods during which the 10f and 12f signals are not on. In fact, the system will "integrate" indefinitely without the 10f and 12f as long as the 9f is not interrupted long enough for the tracking filters to wander too much. Oscillators in use in 1954 were good enough to tolerate 5 minutes' silence on the 9f without loss of lane provided straight and level flight was assumed. In fact, if the 9f skips a lane or two in a period of no signals, when the signals come back on the air, the 12f and 10f, when employed separately in the foregoing manner to produce the notching 3f and 1f signals respectively, will return the coarse meter 42 back so that it will read out the correct 9f lane pro-

vided the undetected drift does not exceed 4½ 9f lanes during the period of no signals (*i.e.*, ±36 n.m.). Similarly, a short term random aberration in the signals can cause an erroneous lane reading, but after the aberration passes, the system will return to accurate navigation in the same way.

(e) The same considerations are applicable to long term aberrations resulting from, for example, diurnal variations of frequency dispersion. If, as an example, there is an aberration in the 9f signal from station A, the divider 29 will be driven by the 9f and the aberration will also appear in the output of the divider 29 with the 3f exactly in alignment with the driving cycle of the 9f. At mixer 35, the incoming 12f is assumed to be without error. This means that the only erroneous phase shift is in the 9f and when the 9f and 12f from station A are mixed (heterodyned) the erroneous phase shift will carry through without change into the beat note, and the 3f output of mixer 35 will be in error by an amount dependent on the magnitude of the original aberration. Such an error in the 3f, however, is immaterial if it is short of the 60° in the 3f noted above which is required to shift the 3f output of the divider 29 to a different driving cycle of the 9f. Assuming that it is, after the 12f goes off, the divider 29 will remain in the same "notch," just as if the mixer 35 had not injected any signal. Similarly, the divider 32 (which is driven by the output of divider 29) remains unchanged after the departure of the transient signal from mixer 35.

The same analysis applies to the next level of division from 3f down to 1f. Here the injected 1f signal from mixer 38 comes in after the mixer 35 goes off, and as above, it must likewise be more than 60° out of phase with the output of divider 29 on the 1f scale (or more than 180° out of phase on the 3f scale) to cause divider 32 to adopt a different one of the three pulses from divider 29 as its driving force.

In the '816, the 1f difference frequency (*i.e.*, the beat note of the 9f and 10f at the output of mixer 38), is used only to identify which notch of the 3f is the correct one. This means that it can tolerate substantially more (*i.e.*, three times the aberration) without throwing the system into error than would be the case if only the 1f difference frequency were used to identify the 9f notch. A 9 to 1 system can tolerate no

more than 20° aberration in the 9f; however, in the '816 by use of the 3f difference frequency (*i.e.*, the beat note of the 9f and 12f at the output of mixer 35), the correct 9f notch can be identified first on a 1 to 3 basis in the presence of 60° aberration in the 9f, and the 1f can identify the correct 3f notch also on a 1 to 3 basis and also in spite of a 60° aberration in the 9f.

9. In summation, the '816 patent describes a hyperbolic radio navigation system wherein three phase-locked, harmonically related frequencies from each of two (or more) spaced stations, are transmitted and received in a synchronized manner, and then procesed in the receiver to provide a "raw" LOP comprising a fractional lane readout which is dependent on two of the signals (*i.e.*, the 9f from two stations), and a coarse readout of the whole number of the lane which is dependent upon the six received signals from two stations.

The receiver of Figure 7 is designed to tell a navigator, through the readout of meters 41 and 42, which lane out of a group of nine lanes the receiver is in and where in the particular lane the receiver is. If the navigator knows his position to an accuracy that places him in a group of nine lanes, the meters 41 and 42 will read his position without ambiguity. If the navigator does not know which group of nine lanes he is in, the patented receiver is not capable of supplying that information.

10. (a) A commercial Decca Decometer could be used for meters 41 and 42. The meters might display a "raw" (*i.e.*, uncorrected for aberrations, etc.) hyperbolic LOP in numeric or digital form. Defendant's contention that claim 1 requires that the readout must occur, or be updated, on a recurrent cycle which, in seconds, is the reciprocal of the fundamental frequency is in error. What is meant by the statement at col. 1, line 49, and the corresponding statement in claim 1, that the phase difference indicator would indicate "the difference in time of propagation which indicator has a recurrence cycle of time difference indication equal, in seconds, to the reciprocal of the fundamental frequency" is that the magnitude of the time difference of propagation indicated as the receiver passes through successive 1f lanes,

will be the reciprocal of 1f. If, for example, the fundamental is 1.133 khz., as it is in the accused system, the time difference of propagation reflected by the meters would be 0.8824 milliseconds, as the receiver passes from one 1f lane to another 1f lane.

(b) The mathematical expressions in claim 1 of the '816 patent for the output signals radiated by the transmitters contain one or more radian constants. As explained at col. 11, line 9 and at col. 1, lines 33–39, and as one of ordinary skill in the art would readily recognize, each frequency is harmonically related and each is locked in phase relative to the fundamental but the exact time relationship is unimportant so long as it stays the same. An arbitrary phase change may be made in the radiated signals so long as equal phase changes are introduced in the receiver. These arbitrary phase changes are recognized in the symbolic notation which expresses the phase relationships of the frequencies by the constants included in that notation. These constants may range from zero, *i.e.*, no arbitrary phase change, up to any value. In other words, the '816 patent recognizes that an arbitrary phase change may be introduced, the only requirement being that it be used uniformly throughout the system.

(c) The transmission hardware and alignment procedures of the '816 were standard for Decca at the time and the feasibility of the transmitter had been proven and was well-known prior to 1954. The use of VLF (in the 10–14 khz. band) on equipment such as that described in the '816 also was feasible in 1954. Although the embodiment of Figure 7 was never actually built and sold, the related structures of Figures 8 and 9 were. The reason why Figure 7 was not was due to the lack of Governmental authority to build and operate antennas suitable for VLF transmission. Such antennas are very large and their transmission interferes with nearby telephone transmission. Plaintiff, at one time, spent a large sum of money for equipment for VLF antennas on the expectation that the granting of such authority was imminent, but the expectation proved to be false and the plan had to be abandoned.

(d) Switching of transmissions was illustrated in the '816 by means of a rotary "commutator" switch. The '816, how-

ever, lays no stress on this form of switching. Any type of timed switching would do as well and comes within the purview of the '816 disclosure.

(e) The transmission pattern in the '816 is altered periodically for synchronization purposes. The patent, however, makes it clear that other methods of synchronizing switching could be used (col. 5, lines 39–43) and that what was needed was some form of "modification of the transmission for signalling purposes" (col. 9, line 21) so that the receiver would be able to line up correctly in synchronism with the received signals.

(f) Since atomic clocks were not available in 1954 the transmissions in the '816 were performed in a Master/Slave relationship, with the precise timing of the slave transmissions being controlled directly by transmissions from the master. The '816 patent, however, lays no emphasis on this detail and its broad statements of the invention at col. 1, lines 27–44, and col. 3, lines 51–69, merely specify the phase and harmonic relationships and the need for synchronism. None of the claims in issue is limited to the specific Master/Slave relationship disclosed in the patents.

(g) The data processing in the '816 is strictly analog. Thus, the phase angle of the 9f from the A station is compared to the phase angle of the 9f of the B station and the meter 41 reads out the difference in a strictly analog manner. Likewise, the 3f and 1f "notching" signals perform their functions of developing the lane information which is then stored in the dividers and read out on meter 42 in a strictly analog manner. As of 1954, the man skilled in this art, for all practical purposes, had only analog means available to him.

(h) Plaintiff had long been aware of the existence of propagation aberrations of various sorts, and, by 1947, it was already publishing corrections to users of its navigation systems. The '816, however, was concerned with minimizing the effect of propagation aberrations on the accuracy of the lane identification and made no attempt to provide for correcting the fine control to compensate for propagation dispersion. Thus, the '816 provided a simple "raw" position based on crossed "raw LOP's." Such information can be employed for

rendezvous purposes and known propagation errors can be applied to it for navigation. Also, the '816 equipment can be set up at a known location and an accurate correction for propagation errors can be made at that time simply by comparing the readout of the equipment with the known position. Thereafter, if the equipment is monitored or used for a while, the predictable propagation errors can be established, at least on a temporary basis.

11. (a) Accused to infringe is the Omega VLF Navigational System sponsored by the U.S. Navy for world-wide use. That system contemplates Omega transmitters to be located at the following eight locations:

La Moure, North Dakota
Haiku, Hawaii
Bratland, Norway
Liberia
La Reunion Island (France)
Argentina
Tsushima, Japan
Australia

Agreements and/or treaties have been concluded with Norway, Japan, Argentina and Liberia under the terms of which stations may be installed in those countries.

(b) Defendant has procured all of the constituent elements for eight Omega transmitting stations, *i.e.*, 16 transmitters, nine timing and control sets, and eight antenna tuning sets, otherwise designated as follows:

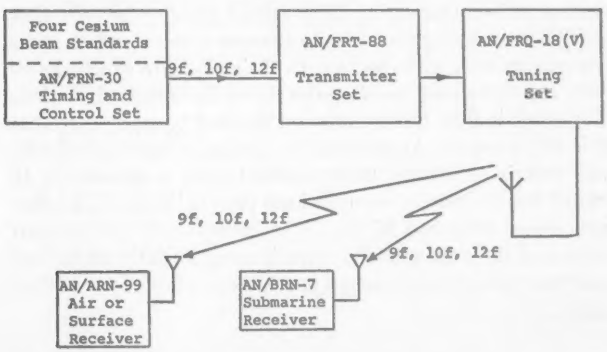
1. Omega Timing & Control Set AN/FRN-30
2. Omega Tuner AN/FRQ-18(V)
3. Omega Transmitter AN/FRT-88

By the time of trial, Omega transmitter stations had been completed, and were operating at La Moure, Haiku and Bratland, Norway, and construction was under way at La Reunion, Tsushima and Argentina. Equipment for stations not yet under construction is stored at Great Lakes, Illinois. The only parts of a complete transmitter system not stored at Great Lakes are the tower and a wound helix coil. The tower is purchased when the station is to be constructed and the helix coil is wound on site.

Findings of Fact

(c) Defendant has procured Omega receivers AN/ARN–99 and AN/BRN–7. The ARN–99 receivers are for use with surface and air craft while the BRN–7 receivers are for submarines. There appears to be no dispute that these receivers have been installed in craft owned by the United States and that these receivers have been used to receive signals both from any combination of two of the three operating Omega stations and from all three stations for navigational purposes, and that this has occurred both within and without the territorial limits of the United States.

12. The Omega system is designed to provide transmissions of 9f, 10f and 12f signals from eight stations spaced to provide worldwide coverage. Each of the stations includes three major components, the AN/FRN–30 Timing and Control set, the AN/FRT–88 Transmitter set, and the AN/FRQ–18(V) Tuning set for the transmitting antenna. The timing and control set includes a set of four redundant cesium beam frequency standards. These cesium standards are ultra-stable atomic clocks, which exploit the phenomenon of atomic resonance, and attain an accuracy of one part in 10^{11}. The transmitter set includes audio power amplifiers, and the tuning set includes a number of relays, which may be selectively closed to direct the 9f, 10f and 12f to the proper tap on a helix coil from which they are commutated out onto an antenna system. The two types of mobile receivers, the AN/ARN–99 and the AN/BRN–7 complete the Omega system. The following block diagram illustrates the basic system:



13. (a) The Omega frequencies are in fixed multiple phase relation, and therefore are harmonics of a fundamental frequency f as follows:

10.2 khz. = 9×1.1–1/3 khz. = 9f
13.6 khz. = 12×1.1–1/3 khz. = 12f
11.33 khz. = 10×1.1–1/3 khz. = 10f

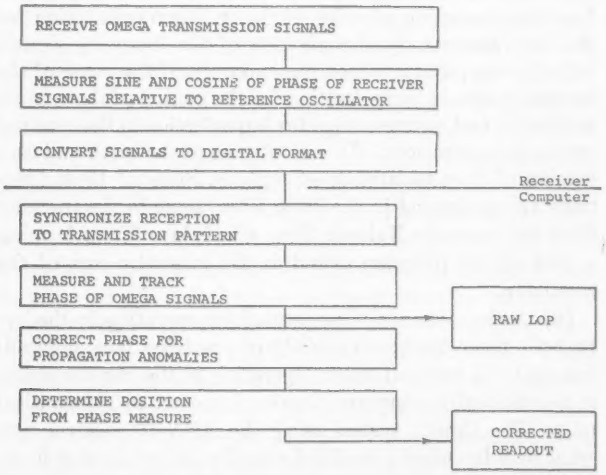
These three frequencies are phase-locked to Universal Time so that all three simultaneously cross zero phase with a positive slope at exactly 0000 hours. At the transmitters the necessary fixed multiple phase relation is obtained by dividing down and synthesizing from a higher frequency generated by the extremely stable atomic clock which has an output of 1 mhz. The 1 mhz. output is divided down to 816 khz., which is an integral multiple of the three Omega frequencies, and that signal is then subjected to a series of digital divisions to produce the correct values to be radiated from the antenna.

(b) The Omega pattern repeats itself with all frequencies rising through zero amplitude at the start of each 30-second epoch from zero Omega time, and a 30-second epoch pulse is used to bring them all into alignment at that instant. If any of the dividers in a given transmitting unit somehow loses phase alignment, as they can on occasion, a warning light comes on, the unit is shut down and the transmissions have to be realigned by the use of a new epoch pulse from another equipment. At the start-up of a new transmitting unit, the alignment is done by starting an atomic clock at an existing station and synchronizing its 30-second epoch pulse with that station, then flying the clock to the new station and starting the transmitting units there with their clocks in synchronism with the 30-second epoch pulse from the original station. The clock is then flown back and checked to make sure that it is still accurate. At each station, there are four such clocks, and each is constantly being checked against the others. If one of the dividers in one unit loses phase alignment, a reference signal from one of the clocks immediately indicates an error and the unit with the error is automatically turned off and reset using the 30-second epoch pulse of one of the other units.

(c) The Omega transmitter system is designed to compensate for any change in antenna capacitance or detuning occasioned by weather changes, snow on the ground, wind forces, and a large number of other factors. Precise control is indispensable because any shift in the antenna capacitance results in a large drop in the radiated output power. A feedback control system samples the values of the current and voltage which are present in the antenna line and from these samples, corrections are made. The Omega system also constantly monitors the phase of the outgoing carrier bursts of VLF and corrects any error discovered. Provision is also made for checking the waveform at numerous points in the system.

(d) The Omega stations radiate their signals in a distinctively altered transmission pattern to facilitate station identification. This is accomplished by the transmission segments having slightly different durations, and the durations are coded so that a receiver can thereby identify each individual station.

14. (a) The basic Omega receivers are illustrated in the following block diagram:


RECEIVE OMEGA TRANSMISSION SIGNALS
MEASURE SINE AND COSINE OF PHASE OF RECEIVER SIGNALS RELATIVE TO REFERENCE OSCILLATOR
CONVERT SIGNALS TO DIGITAL FORMAT
Receiver
Computer
SYNCHRONIZE RECEPTION TO TRANSMISSION PATTERN
MEASURE AND TRACK PHASE OF OMEGA SIGNALS
RAW LOP
CORRECT PHASE FOR PROPAGATION ANOMALIES
DETERMINE POSITION FROM PHASE MEASURE
CORRECTED READOUT

(b) Each receiver uses a reference oscillator to measure the difference in phase between itself and the incoming CW bursts. This oscillator is not as precise as the atomic clock of the transmitting stations, and thus may drift. Also, when the Omega receiver is turned on the oscillator zero time is unknown. However, the fact that the receiver oscillator is not time-synchronized to universal time zero is unimportant, for either the measurements from two stations can be differenced, thus subtracting out the arbitrary oscillator zero time, or the error in receiver oscillator zero time can be calculated, and its drift measured and tracked, thereby permitting single station phase measurements. Position fixing by the first method, using two-station, difference measurements, is referred to as hyperbolic navigation; position fixing by the second, which uses the phase measurements from each station, is called circular or rho-rho navigation.

(c) The receivers are of a single conversion heterodyne design using an RF section in which amplifiers, filters and mixers are among the components making up the hardware. The output of these receivers are digital signals which are fed into a militarized general purpose digital computer. The computer is programmed to perform a whole host of functions including selection of the optimum orientation for the loop antenna, synchronization of the incoming signals with the computer routines, measurement of the phase of the incoming signals, compensation for the motion of the vehicle, prediction and compensation for imperfection in the received waves, compensation for the oblateness of the earth and conversion of data to latitude—longitude. Some of these functions are performed in the burst filter, some in the tracking filter and some the Kalman filter, all of these filters forming a part of the program stored in the magnetic core of the computer.

(d) A three-channel Omega receiver operating in the hyperbolic mode has the capability of resolving lane ambiguities up to 72 nautical miles. Operating in the rho-rho mode, it automatically computes circular lanes out to 144 nautical miles. The Omega system using the ARN–99 receiver uses what may be called a modified rho-rho method in that it determines its initial position by phase differencing the signals

from three stations in the hyperbolic mode; thereafter, as the computer becomes more confident of the oscillator drift calculation, its operation approaches rho-rho where signals from a single station are all that is required. The BRN–7, however, makes no use of the rho-rho mode of navigation, and always requires signals from three stations to get a position fix and signals from two stations to establish a LOP. Both types of receivers, when operating in the hyperbolic mode, process the signals in the same way and both have the capability to display, at any time, an uncorrected "raw" hyperbolic LOP.

15. The 9f, 10f and 12f signals or carrier bursts from the Omega stations must be synchronized with the receiver's own repetitive internal timing cycle which is cyclic and repeats itself once every 10 seconds. The importance of verifying synchronization is that the computer will not initiate the sequencing of any of its computational cycles, or correctly produce the myriad of critically-timed downstream gating impulses required by its logic circuitry, until it has determined where the leading edge of the incoming burst from the station is occurring with respect to its own repetitive 10-second cycle. The receiver uses a mathematical technique called differential correlation involving "short slot" and "long slot" sums to establish synchronization of the receiver's cycle with the incoming transmission. It is the periodic distinctive alteration in the transmission pattern that signals the receiver as to the correct timing of the sequence. The particular method by which the computer processes the incoming pattern of signals to achieve synchronization is immaterial.

16. As the 9f, 10f and 12f signals arrive at a receiver, they are heterodyned down to a common If or 1.1–1/3 khz. (this frequency choice is merely a convenient If frequency and bears no specific relationship to the If used in the navigational problem). The heterodyning, however, is done by mixing with locally generated signals having a fixed phase relationship. Therefore, the IF retains the phase relationships of the incoming 9f, 12f and 10f frequencies without change. Accordingly, when the different transmissions from the respective stations are phase-compared to a local oscillator oscillating at 1.1–1/3 khz., the respective phase rela-

tionships of all the incoming frequencies can be determined and measured. At this point, the phase information (*i.e.*, the difference in phase between the incoming signal reduce to 1.1–1/3 khz. and the local oscillator), is measured and the value is then translated into a series of electrical pulses representing binary digits which are then fed into the computer where they are stored in the memory core in the form of discretely magnetized areas, the stored digital value of which represents the phase of the incoming signal. In this connection, the phase information remains continuously available for use by the computer according to its permanently maintained, built-in program.

17. The manual for the BRN–7 describes the functions of the burst filter, tracking filter and Kalman (combinational) filter as follows:

> 3.1.1.4.7 *Burst Filter:* The function of the Burst Filter is to collect the sine and cosine receiver outputs and calculate the first crude phase measurement as well as an estimate of its credibility based upon the signal-to-noise ratio (from Noise Estimation). It is the combination of the Burst Filter processing and the correlators in the receiver which constitute that referred to as the correlator ratio detector. The resultant phase is corrected for phase errors introduced by the hardware. The measurements, phase, and estimate of validity are transferred to the phase differencing equations before submittal to the Tracking Filters.
>
> * * * * *
>
> 3.1.1.4.10 *Tracking Filters:* Since there are eight possible transmitting stations and three frequencies for each station, there are 24 Tracking Filters. Each Tracking Filter receives an input from the phase differencing equations once every 10 seconds. After differencing, the input to the Tracking Filter consists of a measure of phase difference and a computed variance of this measurement. This measured phase difference is then compared (or weighted in a statistical sense) with an estimated value of phase difference which the Tracking Filter computes based upon previous measurements. From this comparison a new estimate of phase difference is computed. * * *
>
> 3.1.1.4.11 *Combinational (Kalman) Filter:* The outputs of the Tracking Filters are well-filtered value of phase difference along with the estimates of phase differ-

ence variance and phase difference rate variance. It is within the Combinational Filter operations that the outputs of the Tracking Filters are statistically, optimally combined, arriving at "best" error estimates of system position, velocity, and oscillator drift. The error estimates of system position are transmitted to the navigation equations as rotational corrections about the axes of the reference triad while the velocity error estimates are transmitted to Velocity and Heading Processing as corrections along the axes. The error estimate in oscillator drift measures the phase and frequency differences between the local oscillator in the receiver and the transmitted OMEGA signals.

The Combinational Filter is also used for lane determination. Lane determination (laning) is accomplished by use of a multiple state vector technique. The wavelength of each frequency determines a lane within which the receiver position can be determined. The widths of these phase difference lanes are 6, 7.2 and 8 miles, corresponding to the frequencies of 13.6, 11–1/3, and 10.2 khz, respectively. At intervals of 72 miles these lanes repeat, thus defining a larger three-frequency lane width. Resolving the known phase (position) from each frequency into the larger lane is referred to as resolving the lane ambiguity. A three-channel OMEGA receiving set operating in the hyperbolic mode has the capability of resolving lane ambiguities up to 72 nautical miles.

18. (a) Lane identification, for purposes of developing a raw hyperbolic LOP, is made in the Omega receivers by a process involving both frequency differencing and phase comparisons. The receiver computer has accumulated in its storage, within the synchronization period at the start, sufficient information about the phase and sequence of the incoming 9f, 10f and 12f signals from all received transmissions to be able to frequency difference them or to phase compare them as required. Naturally, this information is constantly being updated with the passage of time and is available for determination of a raw hyperbolic LOP in the lane identification mode at any time after synchronization is completed. For each station by frequency differencing the 9f and 10f, 10f and 12f, and 9f and 12f in pairs, difference frequencies of 1f, 2f and 3f respectively can be generated. These difference frequencies from two different stations can then be phase compared so as to locate the receiver within

the corresponding 1f, 2f or 3f zones, which on the base line between the two stations would have widths of 72, 36 and 24 miles respectively. This is "coarse" indication of receiver position within the 72 mile-wide zone (at the base line) corresponding to the Omega 1f fundamental frequency of 1.133–1/3 khz. The digital computer in the receiver performs these operations repeatedly and rapidly, ultimately determining the "coarse" lane identification, *i.e.*, locating the receiver in one of nine 9f lanes in the 1f 72-mile-wide zone.

(b) At this point, the computer will now take single frequency measurements on the 9f from the two stations and, by a phase comparison, determine where the receiver is in the previously identified 9f lane. When this has been accomplished, the receiver will display a digital LOP readout, as, for example, 985.75, the numbers to the left of the decimal being indicative of the 8-mile lane and the numbers to the right indicating the location as a percent of that 9f 8-mile-wide lane.

(c) Thus, the accused receivers are capable of resolving lanes to ±36 n.m. based on receiving all three frequencies, 9f, 10f and 12f, from each of the stations. If the navigator does not know his position within ±36 miles, the Omega system cannot supply that information. But assuming that he does, both types of receivers are programmed to display, upon command, a raw hyperbolic LOP which identifies which lane out of a group of nine the receiver is in and where the receiver is in that lane. It is by a process of differencing the frequencies and comparing their phases that the receiver arrives at a determination of which lane it is in. Through a phase comparison of the 9f signals, its position in that lane is ascertained.

(d) Both in determining its original position in a 72-mile lane, and at other times, the computer section of the receiver utilizes a mass of other data to arrive at a solution. For example, stored in the memory of the computer is such information as the coordinates of each Omega station and values of surface conductivity and correction factors which compensate for variations in the propagation velocity affecting the radiation path between each Omega ground station and the receiver. The computer is also constructed to receive, and

utilize, velocity related rate-aiding signals, such as inertial velocity, doppler velocity, and true airspeed, as sensed by external sensors.

19. The Omega navigational system is readable on claim 1, as follows:

Clause 1.

A hyperbolic radio navigation system in which a position line is determined by indicating the difference in the time of propagation to a receiver of signals emitted from two stations in known spaced geographical positions,

Omega obviously employs the hyperbolic navigation technique to resolve the problem of lane identification. Both of the accused receivers are equipped to read out a raw *hyperbolic* LOP. This means that the position line is determined by indicating the difference in time of propagation to a receiver of signals emitted from two stations in known spaced geographical positions.

Clause 2.

wherein three signals are emitted from a first station satisfying the respective phase conditions, given in radians of angle $n_1\omega_0 t+a_1$, $n_2\omega_0 t+a_2$ and $(n_1+1)\omega_0 t+a_3$, and three signals are emitted from the second station satisfying the respective phase conditions $n_1\omega_0 t+a_1+k$, $n_2\omega_0 t+a_2+k$ and $(n_1+1)\omega_0 t+a_3+k$, wherein n_1 and n_2 are integers, ω_0 is 2π multiplied by a fundamental frequency in cycles per second, t is time in seconds and a_1, a_2, a_3, and k are constants,

The phase conditions of Omega's 9f (10.2 khz.); 12f (13.6 khz.); and 10f (11-1/3 khz.) answer to the above analytical expression. They are transmitted in such a way that all frequencies cross zero amplitude, rising at zero Omega time which means that all of the constants in the above expression are zero. Nothing in the '816, however, requires these constants to have any particular value, all that is necessary is that they be constant. They are in Omega.

Clause 3.

the transmissions being switched in sequence such that the signals of each frequency are transmitted from one station during intervals of the transmissions of the same frequency from the other station,

In Omega no two stations transmit the same frequency at the same time. This is essential because, at the receiver, the reception of two such signals of the same frequency simultaneously would simply sound like one and the phase information would be a combination of the two rather than the phase information of either one. Accordingly, the switching as defined is necessary and Omega meets this limitation.

Clause 4.

and the transmissions being distinctively altered periodically for synchronizing switching means at the receiver with the switching of the transmissions and

In the Omega pattern, the respective CW segments have slightly different durations which are coded for the purpose of synchronizing switching means in the receiver. This is clearly a periodic "distinctive alteration," in the sense intended in '816.

Clause 5.

wherein the receiver comprises means for receiving the radiated signals,

Omega obviously has this.

Clause 6.

switching means which are synchronized by the distinctive alteration in transmission and which are arranged to separate the received signals from the two transmitters,

Both of the accused receivers have switching means at the receiver synchronized to the transmission pattern. The switching is done by "gating" and by circuit sequencing in the computer, controlled by a clock in the computer, which routes the digital phase information of the separately received signals to the appropriate storage locations in the core.

Clause 7.

and a phase difference indicator for indicating the difference in time of propagation which indicator has a recurrence cycle of time difference indication equal, in seconds, to the reciprocal of the fundamental frequency,

The "recurrence cycle of time difference indication equal, in seconds, to the reciprocal of the fundamental" refers to

the fact that the "zone" in which lane identification is feasible is 1f wide, and beyond that distance the 1f phase difference indication, upon which the lane identification depends, repeats itself and is therefore ambiguous. The lane identification in both the ARN–99 and BRN–7 answers to this same definition. The two accused receivers are capable of resolving lanes to a maximum of ±36 n.m., but only when all three frequencies from two stations are being received. The readout provides both the whole number of the lane (good to within ±36 n.m.) and the fractional part within an 8 n.m. lane as a decimal number (to the right of the decimal point). This also corresponds to the published Omega charts which are set up to emphasize every ninth 10.2 lane, *i.e.*, a zone of 72 n.m. width on the base line.

Clause 8.

said indicator being operated by a fine control and a coarse control,

In Omega, the "raw" LOP is developed by a direct phase comparison between the 9f signals from two different stations. Such a comparison, however, only gives the "percent of lane" figure, *i.e.*, the numbers to the right of the decimal point on the display. The numbers to the left of the decimal point are developed by the frequency differencing mode to resolve the lane. The only effect of the frequency differencing mode is to develop the whole number of the lane, and in this sense (as in the '816), it is a "coarse control," while the percentage of lane is the "fine control."

Clause 9.

said fine control being dependent on a pair of signals derived from locally generated non-interrupted signals, one of which is phase-controlled by only one of the signals received from said first station and the other by only one of the signals received from said second station

In the accused Omega receivers, the "fine" LOP readout of the fractional position within a 9f or 10.2 khz. lane is derived from phase-comparing a 10.2 khz. signal from each of two stations. The way this is done is first by receiving the signals sequentially. When each comes in it is phase-compared to a local oscillator and its phase difference is extracted therefrom and converted to a pulse train representing the

digital value of the phase difference. This pulse train is a "locally generated signal" and it is then fed to the computer and stored in the form of discrete magnetized areas in the memory core. In this form it is in a continously available status. Thus, in the accused receivers, the phase information is effectively a "locally generated non-interrupted signal." Of course, the signal is up-dated periodically, as it must be in any system in which the receiver is moving. But the signal is "non-interrupted" in the sense intended by the patent in that it is continuously available for comparison to provide a "fine" indication whenever the operator calls for a raw LOP readout. Thus, in the accused receivers the fine control for the readout of the position in a 10.2 khz. lane is derived from locally generated non-interrupted signals from two stations. But for the fact that it is done digitally in the accused receivers and analog in the '816, the two systems are identical.

Clause 10.

and the coarse control being dependent on six received signals derived from the three different frequencies transmitted from each of the stations.

The accused receivers go into the "frequency difference" mode to resolve lanes and all three frequencies from two stations are needed to resolve the lane to a "zone" width of 72 n.m. by the frequency differencing and phase comparison techniques described in finding 18.

20. Claim 4 is as follows:

A hyperbolic radio navigation system as claimed in claim 1 wherein, at each station, the various different frequencies are radiated in sequence.

There is no doubt that the Omega signals are radiated in sequence.

21. Claim 11 is as follows:

A hyperbolic radio navigation system as claimed in claim 1 wherein there is provided a third transmitting station radiating signals satisfying the respective phase conditions given in radians of angle, $n_1\omega_o t+a_1+k_1$, $n_2\omega_o t+a_2+k_1$ and $(n_1+1)\omega_o t+a_3+k_1$ where k_1 is a constant, the transmissions being switched in sequence such that the signals of each frequency are transmitted from one station during intervals of the transmissions

of the same frequency from the other stations, and wherein the receiver is provided with two of said phase difference indicators, one indicator being arranged to indicate the difference in time of propagation of signals from the first and the second stations and the other being arranged to indicate the difference in time of propagation of signals from the first and third stations.

By using three stations, the Omega receivers are able to display a pair of LOPs from which a position fix can be obtained.

22. **(a)** Under terms of an agreement, Norway acquired the land for the transmitter site at Bratland at no cost to defendant. The United States supplied, at no cost to Norway:

(a) All necessary electronic, communications and monitoring equipment.
(b) Technical assistance for installation and initial operation.
(c) Design information for construction of the station.

Title to all the equipment rests in the United States, but Norway retains sovereignty over the transmitter site. In addition, the station was to be operated by personnel designated by Norway, but trained at U.S. expense. The entire cost of construction, operation and maintenance of the station was to be at U.S. expense. Norway was to be responsible for ensuring continuous operation of the station in phase with the world-wide Omega complex. The U.S. was to bear all costs and expenses for any claims resulting from operation of the station, including any legal expenses and any settlements. In fact, defendant was responsible for synchronization management of the Norway station at least during its first months of operation.

(b) The United States is also paying for the construction of the stations in Argentina and Liberia but not for the stations in La Reunion or Japan. However, defendant is supplying the equipment, without cost, at least to Japan, and title to that equipment is to remain in the United States.

(c) Operation of the Omega transmitter in Norway was initiated by flying an atomic clock to the transmitter to establish phase synchronization. Thereafter, the operation has continued under monitoring control from the United States.

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The foreign transmitter sends out the Omega signals according to the Omega format previously established by defendant. The United States is the sole controlling and guiding force behind Omega.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that claims 1, 4 and 11 of U.S. Patent No. 2,844,816 are valid and infringed. The amount of recovery to which plaintiff is entitled as reasonable and entire compensation shall be determined in further proceedings pursuant to Rule 131(c)(2).

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537 F. 2d 474

RUSSELL CORPORATION, FORMERLY KNOWN AS MONITOR PUBLICATIONS, INC. v. THE UNITED STATES

[No. 64-73. Decided July 9, 1976]

ON THE PROOFS

Contracts; breach; proposed exchange of real property; Federal Property and Administrative Service Act of 1949; implementing regulations.—Plaintiff claims representatives of General Services Administration (GSA) in 1969-70 negotiated a contract to exchange plaintiff's real property for Government property, and seeks breach damages for defendant's refusal to go forward and transfer the properties. The exchange involved plaintiff's property having an appraised fair market value of $405,000, plus $15,000 in cash, for Government property having a fair market value of $420,000 when appraised on the basis of its current zoning, and a value of $720,000 if zoned for high-density-occupancy usage. On December 26, 1968 plaintiff submitted its first offer and on July 29, 1969 its final firm offer on forms prepared by GSA regional representatives; on August 5, 1969 the regional administrator forwarded the offer to the Public Building Service (PBS) commissioner for approval; on October 10, 1969 the Property Management and Disposal Service (PMDS) assistant commissioner recommended that the GSA administrator request the Budget Bureau to approve the transfer of the property from the Justice Department to GSA; on December 8, 1969 the administrator took such required action; on January 16, 1970 Budget Bureau approval was given; on February 19, 1970 the GSA regional

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office was authorized to conclude the exchange after obtaining updated appraisals; on March 23, 1970 such appraisals were submitted, unchanged from the originals; on April 6, 1970 the regional office decided not to proceed with the exchange because it feared they would be subjected to criticism if proposed changes in zoning ordinances permitted high-density usage that had not been considered in the independent appraiser's reports; and on April 29, 1970 GSA's central office advised the regional office that the value estimates in the updated appraisals were approved. It is *held* (1) that while the GSA administrator approved the offer when he requested approval by the Budget Bureau on December 8, 1969 in compliance with GSA Order ADM 7800.6, the parties knew that this approval was qualified and that additional actions had to be completed, such as updated appraisals; accordingly, at this stage plaintiff's offer was not accepted by the December 8, 1969 approval; (2) that up to April 6, 1970 when the top-level regional staff meeting occurred, all participants to the exchange knew that additional actions under the regulations remained to be completed before a contract could come into existence. Furthermore, the updated appraisals did not comply with official requirements because made on the basis of existing zoning restrictions, valuations for rezoning for the highest and best use were not included, and by the time the central office approved the updated appraisals, plaintiff's offer had been rejected; (3) that no implied-in-fact contract came into existence; and (4) that the Government is not estopped from repudiating its obligations—such damage as plaintiff may have suffered did not result from reliance on the conduct or misrepresentations of the GSA officials concerned with the exchange. Plaintiff is not entitled to recover and the petition is dismissed.

Contracts; formation of contract; intention to be bound.

[1] For there to be an express contract, the parties must have intended to be bound and must have expressed their intention in a manner capable of understanding. Where the subject contract documents were not executed by a Government representative, throughout the negotiations plaintiff was cognizant of the limitation on the authority of the regional officials and recognized the interrelatedness of the various approval actions required by the regulations, and the regional officials authorized to act for the Government changed their minds and withdrew their previously granted assent prior to execution of the documents, no express agreement came into existence.

United States ⇦ 63

Contracts; implied contracts; implied in fact.

[2] A contract implied in fact requires a showing of the same mutual intent to contract as that required for an express contract; only the nature of the evidence differs. Here, although the GSA administrator had approved the terms of plaintiff's offer and the

deputy commissioner of Public Building Service had authorized the exchange of property to be concluded, all parties understood and agreed that the exchange would not be completed until there had been compliance with applicable regulations.

United States ⇐ 69(1)

Contracts; implied contracts; implied in law; Court of Claims jurisdiction.

[3] The Court of Claims does not have jurisdiction to render judgment against the United States based upon a contract implied in law.

Courts ⇐ 449(1)

Estoppel; equitable estoppel; nature and essentials.

[4] The doctrine of equitable estoppel will be applied by this court in an appropriate case to prevent the United States from denying the existence of a contractual agreement. The elements of estoppel are: the party to be estopped must know the facts, he must intend that his conduct shall be acted on or must so act that the party asserting the estoppel has a right to believe it is so intended, the latter must be ignorant of the true facts, and he must rely on the former's conduct to his injury.

Estoppel ⇐ 62(2)

Regulations of Executive Department; construction and operation; Federal Property Management Regulations.

[5] Limitations in the Federal Property Management Regulations were devised for the specific purpose of protecting the Government from precipitous actions that might lead to unwise bargains. Their goal is to prevent actions that subsequently could subject the Government participants to criticism that the public's property had been inadequately protected.

United States ⇐ 58(1)

O. P. Easterwood, Jr., attorney of record, and *Conrad Philos*, for plaintiff. *Lansford F. Butler*, of counsel.

Floyd France, with whom was *Assistant Attorney General Peter R. Taft*, for defendant. *Herbert Pittle*, of counsel.

Before NICHOLS, KASHIWA and BENNETT, *Judges*.

PER CURIAM: This case comes before the court on plaintiff's exceptions to the recommended decision of Trial Judge Kenneth R. Harkins, filed December 9, 1975, pursuant to Rule 134(h), having been submitted to the court on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended

decision, as hereinafter set forth,* it hereby affirms and adopts the same as the basis for its decision in this case. It is therefore concluded that plaintiff is not entitled to recover and the petition is dismissed.

OPINION OF TRIAL JUDGE

HARKINS, *Trial Judge:* Plaintiff claims representatives of the General Services Administration (GSA) in 1969–70 negotiated a contract to exchange plaintiff's property, lots 2 through 10, block 111, East Denver, Colorado, for 120 acres, in two tracts, of former Federal Correctional Institute property located in Jefferson County, Colorado, and seeks breach damages for defendant's refusal to go forward and transfer the properties. In the exchange, plaintiff would have conveyed real estate with an appraised fair market value of $405,000, and $15,000 in cash, for Government property with a fair market value of $420,000 when appraised on the basis of then current zoning, and a value of $720,000 if the area were zoned for high-density-occupancy usage. Defendant concedes that the proposed agreed price was $300,000 less than the actual fair market value of the Government land at the time in question.

Discussions relative to the exchange agreement commenced on June 28, 1968, when plaintiff was notified that GSA's regional office (region 8) had agreed with the Denver Urban Renewal Authority (DURA) that the entire block 111 would be acquired by GSA in connection with its plans for the Denver Federal building complex. Plaintiff's first formal offer, with a $1,000 earnest money deposit, was submitted on December 26, 1968. Subsequently, on February 24, 1969, the GSA administrator authorized the regional administrator to initiate negotiations for an exchange; by June 6, 1969, an independent contract appraiser had reported on both parties' properties; and, on July 29, 1969, plaintiff submitted its final firm offer on forms prepared by, and in terms acceptable to, GSA's regional representatives. Thereafter, the GSA administrator approved the exchange and, on December 8, 1969,

*Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed December 9, 1975, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

requested the Budget Bureau director to approve transfer of the property from the Department of Justice to GSA, which approval was granted on January 16, 1970. The regional office, on February 19, 1970, was authorized to conclude the exchange after obtaining updated appraisals. Updated appraisals, unchanged from the original appraisals, were submitted by March 23, 1970. At this stage, GSA's regional office, on April 6, 1970, decided not to go forward with the exchange because the regional personnel were fearful they would be subjected to criticism in the event proposed changes in Denver zoning ordinances would permit high-density usage that had not been considered in the independent appraiser's reports. Finally, on April 29, 1970, GSA's central office advised the regional office that the value estimates in the updated appraisals, and the investigation of local zoning on which they were based, were approved.

Plaintiff contends that, under GSA regulations, the regional representatives had agreed upon the terms of the exchange and that this agreement became binding and enforceable when the mechanical formalities of subsequent administrative actions and approvals had been concluded. The issue is whether, under the statute and GSA's regulations applicable to exchanges of real property, GSA representatives in region 8 had the power to change their negotiating posture during the period when administrative formalities remained to be concluded, but which were ultimately concluded in the manner the parties originally had contemplated.

For the reasons set forth, GSA's regional representatives acted within their powers and no contract came into existence.

GSA's authority to enter into an exchange agreement with plaintiff is derived from the Federal Property and Administrative Services Act of 1949.[1] The GSA administrator is authorized to supervise and direct disposition of surplus property and utilization within the Government of excess property that is not required for the needs of a particular Federal agency.[2] In the exercise of his responsibilities for the

[1] 63 Stat. 378, 40 U.S.C. §§ 471 *et seq.* (1970).
[2] 40 U.S.C. §§ 472 (e), (g) and 484(a)–(b) (1970).

operation and maintenance of governmental buildings, properties, and grounds, the GSA administrator can acquire by purchase, condemnation, or otherwise, real estate and interests therein.[3] The GSA administrator is authorized to promulgate such regulations as he deems necessary to effectuate his functions under the act,[4] and may delegate and authorize successive redelegations to any official of the General Services Administration.[5]

The powers conferred in the Federal Property and Administrative Services Act of 1949 have been implemented by the Federal Property Management Regulation.[6] Transfers of property that is excess to the needs of a particular agency in the executive branch to the GSA for use by another agency or for disposal are regulated by subsection 101–47.203–7. This section prescribes the use of GSA Form 1334[7] and requires approval of the Bureau of the Budget (now Office of Management and Budget) in transfers that involve properties having an appraised fair market value of $100,000 or more.[8] Budget Bureau approval is required for transfers of real property between Government agencies; BOB approval of the terms of exchange contracts between GSA and outsiders is not required.

The essence of plaintiff's case is found in the relationship between GSA's regional offices and the Washington central office in procedures for dealing with parties outside the Federal Government. GSA functions at three levels of organization—the central office, located in Washington; 10 regional offices; and special field activities. Supporting staff functions are in the central office; operations are administered largely by regional and field offices. The regional offices, headed by regional administrators (formerly regional commissioners)

[3] 40 U.S.C. § 490(a)(12) (1970).
[4] 40 U.S.C. § 486(c) (1970).
[5] 40 U.S.C. § 486(d) (1970).
[6] 41 C.F.R. Part 101–47, Utilization and Disposal of Real Property.
[7] GSA Form 1334, entitled "Request for Transfer of Excess Real Property and Related Personal Property," provides relevant identifying information with respect to the property to be transferred, a detailed statement of justification for the proposed use of the property after the transfer, and a certification by the responsible GSA official that the property identified and the transfer thereof would be in accord with an approved program and consistent with the policy guidelines established by the Bureau of the Budget. In this case, the certification was signed by the regional administrator, region 8.
[8] 41 C.F.R. § 101–47.203–7(c).

are completely integrated and parallel the organizational pattern of the central office. General operating authority for supervision of GSA programs in a particular region has been granted to the regional administrator, under comprehensive delegations of authority, so that the regional administrators are the active and fully empowered heads, with the usual managerial responsibilities, in their respective offices.[9]

The Public Building Service (PBS) is responsible for design, building or leasing, operation, protection, and maintenance of Federal buildings.[10] When plaintiff's exchange agreement was negotiated, GSA personnel in the Property Management and Disposal Service (PMDS) and in PBS had responsibility for exchanges of real property. PBS was responsible for the type of exchange involved with plaintiff; but personnel from both services—in region 8 and in the central office—were active on plaintiff's exchange agreement.

In the central office, GSA officials concerned with plaintiff's contract were the GSA administrator, PBS commissioner, PMDS commissioner, and PMDS appraisal staff director; in region 8, the officials were the regional administrator, PBS regional director, PMDS regional director, and PMDS appraisal staff chief. The PBS regional director was responsible for development and negotiation of the exchange agreement.[11]

Internal GSA procedures applicable to the exchange of real property in this case are provided in two regulations: GSA Order ADM 7800.6, "Exchange of Government-owned real property" (Oct. 10, 1968), and a PMDS All Regions Memorandum, dated September 4, 1969, entitled "Exchange of Surplus Real Property." [12] ADM 7800.6 is the basic order

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[9] United States Government Organization Manual 1975/1976, 510–13. Delegation of the Administrator, 23 Fed. Reg. 5726 (July 30, 1958); 24 Fed. Reg. 10681 (Dec. 24, 1959); 32 Fed. Reg. 9585 (July 1, 1967); and 34 Fed. Reg. 9633 (June 19, 1969). *Monahan* v. *United States*, 173 Ct. Cl. 734, 738, 354 F. 2d 306, 309 (1965).

[10] PBS was established on December 11, 1949, pursuant to the authority contained in the Federal Property and Administrative Services Act. PMDS was established on July 29, 1966. By 1973, PBS had absorbed some PMDS functions and was responsible for the disposal of real property and related personal property. 38 Fed. Reg. 32292 (Nov. 29, 1973).

[11] The names and titles of the specific individuals involved are set forth in the detailed findings of fact.

[12] The memorandum was addressed: "All Regional Administrators, ATTN: All Regional Directors (PMDS)."

for exchanges of real property. As in the case of procedures for acquisition or disposition of realty in most corporate or large organizations, it is complex and its structure reflects the special character of land transactions. The attachment to ADM 7800.6 requires several stages of consideration and approvals at the highest levels of GSA's hierarchy.

ADM 7800.6 divides realty exchanges by type between PMDS and PBS, and provides that PBS shall be responsible for real property exchange transactions for the acquisition of property for an "authorized GSA program use," which includes the acquisition of real property for parking, motor vehicle facilities, and other facilities for which PBS is responsible.[13] Where excess property of another Government agency is involved in a PBS exchange, the regulation provides that custody and control of the property "shall be transferred by PMDS to PBS, prior to initiation of the exchange transaction." [14]

The attachment to ADM 7800.6 recites that the economic magnitude, complexities, and statutory involvements in an exchange program require a high degree of coordination by the PBS and PMDS and free exchange of information at both the central office and regional levels.

The importance of agreements to exchange land is underscored by the prominent role played by the GSA administrator in the procedures. Section 5 of ADM 7800.6, with five subsections, is devoted to steps in the sequence that require his approval. Approval of the GSA administrator is required before any proposed exchange is initiated, and independent appraisals are not to be obtained on properties in the PBS inventory that are eligible for consideration in an exchange prior to approval of the plan by the administrator. Although GSA personnel may make preliminary evaluations of property to be acquired in potential exchange transactions, con-

[13] GSA Order ADM 7800.6 § 4a(3).

[14] GSA Order ADM 7800.6 § 4b reads:

"b. In instances where PBS identifies excess property desired for use in exchange transactions under a, above, subject to a determination by PMDS that the property is available for the proposed use, custody and control over the property shall be transferred by PMDS to PBS, prior to initiation of the exchange transaction, after compliance with section 202(a) of the Federal Property and Administrative Services Act of 1949, 63 Stat. 384, as amended (40 U.S.C. 483(a)), as implemented by FPMR 101–47.203–7, including clearance with the Bureau of the Budget, if required."

tract appraisals by independent outside appraisers "shall not be obtained on properties to be acquired nor shall negotiations be initiated prior to approval of the exchange plan by the Administrator." [15] During discussions with property owners needed to develop an exchange plan for submission, ADM 7800.6 directs that the property owners "be advised that such discussions are of a preliminary nature only and cannot be considered in any way as being a commitment until the proposed exchange has been approved by the Administrator." [16] When the GSA administrator has approved initiation of the plan, the procedures require the region to obtain necessary appraisals and to arrange for PMDS to transfer to PBS excess property from other agencies prior to proceeding further with the exchange.[17]

The region's authority to negotiate a final exchange agreement must follow review and approval of the contract appraisals, and, when the negotiations produce an acceptable exchange agreement, the region must submit a detailed report "to the appropriate commissioner for review and recommendation to the Administrator." [18]

In addition to required action by the GSA administrator, other actions by the central office further limit the regional administrator's authority in exchange procedures. The regional administrator must submit a proposed plan to the appropriate PBS or PMDS commissioner for review, approval, and recommendation to the administrator before the exchange is initiated. During subsequent negotiations, the regional administrator must obtain approval at the commissioner level before third parties may be involved [19] or before concluding a negotiation where the acquired property

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[15] GSA Order ADM 7800.6, Attachment ¶ 5b.

[16] GSA Order ADM 7800.6, Attachment ¶ 5c.

[17] GSA Order ADM 7800.6, Attachment ¶ 5d. When excess properties are to be transferred to PBS for an exchange, prior to submission of the final GSA Form 1334, PBS must secure the GSA administrator's approval on the exchange plan. GSA Order ADM 7800.6, Attachment ¶ 6b.

[18] The text of paragraph 5e of the attachment to GSA Order ADM 7800.6 is:
"e. Following approval of the appraisals, active negotiations shall be undertaken to accomplish the exchange. When negotiations have progressed to the point where the exchange is acceptable, a detailed report shall be submitted to the appropriate Commissioner for review and recommendation to the Administrator."

[19] GSA Order ADM 7800.6, Attachment ¶ 8a.

is not "at least 100 percent of the approved appraised fair market value of the property offered for the exchange." [20]

The regional administrators were further restricted by directions for appraisals of Government property by the September 4, 1969, PMDS All Regions Memorandum. This memorandum requires that appraisals to determine the fair market value of the Government property to be exchanged must reflect possible changes in local zoning regulations. The appraiser must give weight to "proposed local zoning covering that property," and, where possible, the proposed zoning "should be confirmed in writing by the zoning authority." Appraisals should reflect not only current zoning, but should include comments as to whether the zoning is in accord with the highest and best use of the property; the possibility of future changes in zoning and an evaluation of the effect of any change should be discussed. If the value estimate based on indicated local zoning varies with a value estimate based on the highest and best use by more than 10 percent, the appraiser is to furnish the additional value estimate separately.

After the exchange is completed, zoning changes are required to be reported to the central office. The memorandum states:

> Also, the Regional Director shall be responsible for informing the Central Office of any increase in value of the property due to rezoning or any other developments at any time before the explanatory statement is submitted to the Congressional Committees on Government Operations.

In this case, there is no dispute that there was compliance with the procedures required by regulation in the numerous stages of development and negotiation that transpired through the time plaintiff's offer was put in final form, in

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[20] GSA Order ADM 7800.6, Attachment ¶ 8b is:

"b. *Vigorous negotiations required.* All exchange negotiations shall be conducted vigorously to obtain, in return for the Government's property, other property of equal or higher value or other property plus cash, taking into consideration where justified the unusual or unique need for the property to be acquired. No exchange negotiation shall be concluded without approval of the Commissioner, PBS, or Commissioner, PMDS, as appropriate, unless the value of the property to be acquired is at least 100 percent of the approved appraised fair market value of the property offered for the exchange."

terms then acceptable to the regional office, and forwarded on August 5, 1969, to the central office with a recommendation for approval. There is a dispute, however, whether, under the regulation, the GSA administrator approved plaintiff's final offer. Plaintiff contends express direct approval of the GSA administrator is not necessary under the regulation for a valid and binding contract to come into existence, but, in any event, in this case, such approval in fact was given. Defendant insists that the GSA administrator's approval never was given as required by ADM 7800.6, Attachment ¶ 5e, to a final agreement and that negotiations for the exchange could not result in a contract, express or implied, in the absence of such final express approval.

There is no question that the GSA administrator had to approve the exchange after it had been negotiated to the point where it was "acceptable." The regulation is silent, however, as to how the approval is to be communicated to the regional administrator or when the negotiation stage has been completed at the regional level.

The GSA administrator was involved and had given his approval in many stages in the development of this exchange. The administrator, during a visit to Denver on June 4, 1968, had given approval orally to the acquisition of block 111 in a conversation with the regional administrator, and had given written authority to initiate the exchange on February 24, 1969.

Plaintiff's offer in final form was delivered on July 29, 1969. The regional administrator forwarded it on August 5, 1969, to the PBS commissioner for approval, together with GSA Form 1334, with its attached statement of justification that explained the exchange transaction in detail. Since this exchange involved property that had to be transferred from the Department of Justice to GSA, the GSA administrator had to request the approval of the Budget Bureau director. On October 10, 1969, the PMDS commissioner and the PBS assistant commissioner jointly recommended that the GSA administrator act to obtain this approval. The joint memorandum advised the GSA administrator that, prior to completion of the exchange, the region would review the appraisals in accordance with the September 4, 1969, All

Regions Memorandum to ascertain that there had been no significant change in the proposed zoning of the Government-owned land or in the value of the property, and that, upon approval of the BOB director, "the Regional Administrator in Denver will be authorized by this office to conclude the exchange in accordance with GSA Order ADM 7800.6, paragraph 4a(3)."

On December 8, 1969, the GSA administrator took the required action to obtain the approval of the BOB director by forwarding the final GSA Form 1334 with its explanatory justification. Budget Bureau approval was granted on January 16, 1970, for the transfer of the property from the Department of Justice to GSA and, on February 2, 1970, the property was transferred.

In this case, the requirement of ADM 7800.6, Attachment ¶ 5c, that the GSA administrator approve the exchange after conclusion of negotiations is satisfied by his request to BOB to approve GSA Form 1334. To make such request, the GSA administrator necessarily had to approve plaintiff's offer for the exchange. In the absence of a failure in any of the other steps that remained to be taken, there would have been compliance with the requirements of the regulation and the exchange could have been concluded without further action by the GSA administrator. The procedures permit notice to be given to the region of the GSA administrator's approval by the PBS and PMDS commissioners; further steps in the exchange then may be completed by the commissioners or by regional officials.

A direct communication from the GSA administrator to the region signifying his approval is not required by ADM 7800.6. It was not customary agency practice for the GSA administrator to sign the exchange plan documents that had originated in the region. The version of Exchange Plan No. 3 (Revised) that the GSA administrator approved, although the form had blanks for concurrence by the PBS commissioner and approval by the GSA administrator, did not go forward and was not signed by the GSA administrator. Plaintiff's final offer, on a Government form, provided for the regional administrator to accept on behalf of the United States.

Although the GSA administrator expressly approved the exchange that had been negotiated by the region, this approval was qualified. At this stage in the procedure, all parties knew additional actions had to be completed. Plaintiff's offer was not accepted by the approval that the GSA administrator granted on December 8, 1969.

Plaintiff contends that a valid and binding contract, express or implied in fact, sprang into existence on the facts of this case either on February 19, 1970 (when the PBS commissioner authorized the regional administrator to conclude the exchange), or on April 29, 1970 (when the PMDS appraisal staff director notified the PMDS regional director that the updated contract appraisals were approved and that the higher estimate of the PMDS appraisal staff chief was rejected). For there to be an express contract, the parties must have intended to be bound and must have expressed their intention in a manner capable of understanding. A definite offer and an unconditional acceptance must be established. Here, the contract documents that would manifest the offer and acceptance were not executed by any representative of the Government. Further, the regional officers authorized to act for the Government in dealing with the plaintiff changed their minds and withdrew their previously granted assent prior to the time the documents were to be executed. In these circumstances, no express agreement could come into existence.

Under the GSA regulations, authority to make an exchange agreement that would bind the Government was not located in one Government representative. The regional administrator had overall responsibility for operations in region 8 and was the official designated to execute contractual documents on behalf of GSA in matters that affected the region. The contracting officer for region 8 was the regional administrator and plaintiff's agreement could not be concluded without his assent. PBS, however, had responsibility over an exchange of GSA property for the acquisition of plaintiff's property for parking facilities. The agreement for such an exchange is generated at the regional level, with the PBS regional director responsible for preliminary discussions prior to the grant of authority to initiate negotiations,

and for subsequent negotiations that would produce an acceptable agreement. Neither the PBS regional director nor the PBS commissioner had authority to make a contract with plaintiff. Throughout the negotiations, plaintiff was cognizant of the limitation on the authority of the regional officials and recognized the interrelatedness of the various approval actions required by the regulations.

A contract implied in fact requires a showing of the same mutual intent to contract as that required for an express contract. The fact that an instrument was not executed is not essential to consummation of the agreement.[21] It is essential, however, that the acceptance of the offer be manifested by conduct that indicates assent to the proposed bargain.[22] The requirements of mutuality of intent and the lack of ambiguity in offer and acceptance are the same for an implied-in-fact contract as for an express contract; only the nature of the evidence differs.[23]

Implied-in-fact contracts differ from contracts implied in law (quasi-contracts), where a duty is imposed by operation of law without regard to the intent of the parties. Such arrangements are treated as contracts for the purposes of remedy only. This court, of course, has no jurisdiction to render judgment against the United States based upon a contract implied in law.[24]

The regional administrator withdrew his assent to plaintiff's offer and refused to execute the contract on April 6, 1970, after the top-level regional staff meeting. Up to that time, all participants to the exchange, including plaintiff's president, knew that additional actions under the regulations remained to be completed before a contract could come into existence. A contract could not have come into being prior to the April 6, 1970, meeting.

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[21] *United States* v. *Purcell Envelope Co.*, 249 U.S. 313, 319 (1919); *Penn-Ohio Steel Corp.* v. *United States*, 173 Ct. Cl. 1064, 1085, 354 F. 2d 254, 267 (1965).

[22] *Thomson* v. *United States*, 174 Ct. Cl. 780, 791, 357 F. 2d 683, 689 (1966); *Penn-Ohio Steel Corp.* v. *United States*, *supra* note 21, 173 Ct. Cl. at 1086, 354 F. 2d at 267.

[23] *Algonac Mfg. Co.* v. *United States*, 192 Ct. Cl. 649, 674, 428 F. 2d 1241, 1255 (1970).

[24] *Putnam Mills Corp.* v. *United States*, 202 Ct. Cl. 1, 8, 479 F. 2d 1334, 1337 (1973); *Algonac Mfg. Co.* v. *United States*, *supra* note 23, 192 Ct. Cl. at 674, 428 F. 2d at 1256.

Opinion of Trial Judge

On February 19, 1970, the PBS deputy commissioner authorized the regional administrator to conclude the exchange. This authority was expressly qualified. The exchange was not to be completed until (1) updated appraisals on both properties were obtained; (2) such updated appraisals included consideration of possible changes in zoning regulations as required by the September 4, 1969, All Regions Memorandum; and (3) the regional administrator after consideration of the updated appraisals had advised the central office of his proposed actions and of any unusual circumstances in the matter. Before the updated appraisals were obtained and analyzed, plaintiff's president was told about the regional administrator's qualified authorization and plaintiff's president recognized that such actions would have to be completed before the contract could bind the Government. In a telephone conversation on March 26, 1970, with the PBS regional director, plaintiff's president expressed disappointment but did not disagree that the Government could defer final action until April 6, 1970.

Updated contract appraisals for the Monitor property, dated March 4, 1970, and for the Government property, dated March 20, 1970, did not change the values previously given; the Monitor property was appraised at $405,000 and the Government property at $420,000. The updated appraisals, however, did not comply with requirements of the September 4, 1969, All Regions Memorandum. They were made on the basis of existing zoning restrictions and did not include valuations for rezoning for the highest and best use. Both updated contract appraisals ultimately were approved in the regional office and in the central office. The Government property appraisal was approved in the region by the PMDS appraisal staff chief on March 31, 1970, and in the central office by the PMDS appraisal staff director on April 29, 1970. By the time the central office approved the updated appraisal, the regional administrator had rejected plaintiff's offer.

After the updated contract appraisals were submitted, the PBS regional director requested the PMDS appraisal staff chief to obtain, by no later than April 6, 1970, the contract appraiser's value of the Government property in the event

the adjacent properties were to be rezoned for high-density occupancy. The PMDS appraisal staff chief was unable to obtain this value from the contract appraiser and instead, on March 27, 1970 (4 days before he approved the contract appraisal for the Government property), in a memorandum to the PBS regional director, he submitted his own estimate that the Government property would have a value of $720,000 if the adjacent land were to be rezoned for the highest and best use.

During the period this exchange was being negotiated, the Jefferson County School Board became interested in the 80-acre tract of the Government land for use as a service center. A comprehensive account, including a map, was published in the Denver newspapers. In addition, both the regional office and the central office had been concerned about repetition of a situation that had developed with respect to GSA exchanges in the period 1966–67 of property at the Lowry Air Force Base. Reason for this concern was underscored on April 5, 1970, by an article in the Denver Post on the Lowry Air Force Base exchanges. This article contended that the GSA had traded Lowry Air Force Base land, estimated to have a value of $4,000,000, for cash and property estimated to have a value of approximately $680,000. The purport of the article was that, after the exchanges had been made, zoning changes to permit high-density occupancy increased the value of the former Government property and permitted the non-Government participants in the exchange to reap exorbitant profits.

On April 6, 1970, the regional administrator met with the PBS regional director, the PBS Space Management Division chief, the PMDS regional director, and the PMDS appraisal staff chief to consider plaintiff's offer. At this meeting, the regional officials determined, because of the possible similarity to the Lowry Air Force Base situation and the possibility of similar unfavorable publicity, that the Government should not go forward with the exchange.

At the time, on April 6, 1970, when the decision was made not to go forward with the exchange on the basis of plaintiff's offer, no implied-in-fact contract was in existence. Although the GSA administrator had approved the terms contained in

plaintiff's offer, and the PBS deputy commissioner had authorized the exchange to be concluded, all parties understood and agreed that the exchange would not be completed until there had been compliance with the applicable regulations.

Responsibility of the regional administrator for general supervision of regional affairs would include authority to reject plaintiff's offer on the basis of information available to him on April 6, 1970. The regional administrator would have this authority notwithstanding there had not been strict compliance with GSA regulations in the development of such information. The $720,000 estimated value of the Government property was not the product of a formal appraisal by the PMDS appraisal staff chief; nor was his estimate in compliance with GSA practice that, in real estate exchanges, appraisals would be made by independent contract appraisers. The PMDS appraisal staff chief's estimate, however, was in response to an official request for information from PBS on possible rezoning effects, was based on consultations with officials of the Planning and Zoning Board of the county, and was made by a knowledgeable and qualified expert on land values. It was a reasonable basis for the regional administrator's action to reject plaintiff's offer in the light of the fact that the updated appraisals from the contract appraiser did not comply with the requirements of the September 4, 1969, All Regions Memorandum.

On April 29, 1970, the PMDS appraisal staff director in the central office notified the PMDS regional director that the updated appraisal by the contract appraiser on the Government property had been reviewed and was approved. The central office was satisfied that the contract appraiser had made a sufficient investigation to justify the decision concerning the proper zoning on which to base the reaffirmed value estimates. In addition, the PMDS appraisal staff director advised that the March 27, 1970, estimate of $720,000 by the PMDS appraisal staff chief was no more reliable, if as reliable, as the value certified by the contract appraiser.

Both the regional and central office PMDS appraisal staffs approved the contract appraiser's updated valuations. Both agree that such valuations are accurate on the basis of then

current zoning. The PMDS appraisal staff director did not find in his April 29, 1970, memorandum that there was compliance with the standards of the September 4, 1969, All Regions Memorandum, and his rejection of the regional appraisal chief's estimate does not countermand, purge, or supersede the April 6, 1970, action of the regional administrator.

No actions were taken by representatives of the defendant at the regional level after April 6, 1970, that manifest an intent to accept plaintiff's offer. Even if it is assumed that the approvals and other actions required to be taken prior to April 6, 1970, were mere formalities, as plaintiff contends, after that date plaintiff's president knew that the offer had been rejected. He asked for a return of his deposit, and refused to negotiate a new offer on the basis of the higher valuation of the Government property. After April 6, 1970, notwithstanding the subsequent approval on April 29, 1970, of the updated appraisals and the rejection of the PMDS appraisal staff chief's estimate, neither plaintiff's president nor the regional officials took actions that manifest an intent to enter into a contract on the basis contained in plaintiff's July 29, 1969, offer.

Plaintiff also contends that equity and fair dealing require the Government be estopped from repudiating its obligations on the facts of this case. The doctrine of equitable estoppel will be applied by this court in an appropriate case to prevent the United States from denying the existence of a contractual agreement.[25] For the doctrine of equitable estoppel to be applied, however, the facts must show the following elements to be present: (1) The party to be estopped must know the facts; (2) he must intend that his conduct shall be acted on or must so act that the party asserting the estoppel has a right to believe it is so intended; (3) the latter must be ignorant of the true facts; and (4) he must rely on the former's conduct to his injury.[26]

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[25] *Manloading & Management Associates, Inc.* v. *United States*, 198 Ct. Cl. 628, 461 F. 2d 1299 (1972); *Branch Banking & Trust Co.* v. *United States*, 120 Ct. Cl. 72, 98 F. Supp. 757, *cert. denied*, 342 U.S. 893 (1951).

[26] *Emeco Indus., Inc.* v. *United States*, 202 Ct. Cl. 1006, 1015, 485 F. 2d 652, 657 (1973); *United States* v. *Georgia Pac. Co.*, 421 F. 2d 92, 96 (9th Cir. 1970).

On the facts, there is no basis for application of the doctrine of equitable estoppel; none of the requisite elements are present. The regional administrator and the PBS regional director did not know that the value of the Government property exceeded the value of plaintiff's property by more than $300,000 in their negotiations with plaintiff's president or when they recommended approval of plaintiff's offer. After this disparity came to light, they did not engage in a course of conduct that misled plaintiff's president into a belief that his offer would, or even could, be approved.

Throughout the negotiations, both parties recognized that the regulations required the properties to be exchanged to have equivalent values, and that appraisals and updated appraisals would have to be obtained and approved. Such damage as plaintiff may have suffered does not result from reliance on the conduct or misrepresentation of the GSA officials concerned with the exchange.

Examination of the effects on plaintiff resulting from the refusal to go forward with the exchange does not show plaintiff to have the type of equities that are protected by the doctrine of equitable estoppel. Plaintiff had $1,000 in earnest money on deposit for more than a year, and alternative ways of disposing of the Monitor property might have been pursued during this period. Plaintiff's president, however, was experienced in real estate transactions and knowledgeable about the time that would be needed to process the offer. Plaintiff's deposit was returned promptly after it was recognized that the deal could not go forward.

Plaintiff has lost the opportunity to trade property and cash worth $420,000 for property that now is conceded to have been worth, at that time, $720,000. Plaintiff has lost a good piece of business, but plaintiff has not changed its position in reliance on the conduct of defendant's representatives.

Plaintiff has lost the consummation of a beneficial business transaction which, if it had been operating in private markets and had not been doing business with the Government, might have been concluded more expeditiously in the manner plaintiff sought. Plaintiff, however, was cognizant of the limitations imposed on the GSA personnel by regulation, and chose to enter the transaction and to make an offer subject

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to those restrictions. Limitations in the GSA regulations were devised for the specific purpose of protecting the Government from precipitous actions that might lead to unwise bargains. Their goal is to prevent actions that subsequently could subject the Government participants to criticism that the public's property had been inadequately protected.

Inasmuch as no contract was made and defendant has no obligation to pay damages for breach, it is not necessary to determine whether plaintiff would be entitled to any more than the $300,000 difference between the contract price and the actual fair market value of the Government's property at the time of the breach.

CONCLUSION OF LAW

Upon the findings of fact and the foregoing opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover, and the petition is dismissed.

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539 F. 2d 1276

C. E. HOOPER, INC. v. THE UNITED STATES

[No. 68–73. Decided July 9, 1976]

OPINION

Taxes; accumulated earnings tax; reasonable needs of business; working capital needs; contingent needs.—In an income tax refund suit for fiscal year 1966, otherwise conceded, defendant asserts as a setoff defense that plaintiff was availed of for the purpose of avoiding income tax on dividends to its shareholders. Plaintiff was engaged in the business of measurement of home radio audiences and of performing marketing research by telephone interview. Although plaintiff's accumulated earnings as of the close of fiscal 1966 were $612,326, it is *held* that a major portion thereof could not be deemed beyond the reasonable needs of the business because it had been used to pay off a note incurred in a prior year to acquire the business assets. It is also *held* that $241,144 was required for working capital to carry the business through a single operating cycle. It is further *held* that the remaining earnings of $64,238 held in the form of liquid assets were not in excess of what a prudent businessman would retain to meet various contingent business expenditures even though during the fiscal year plaintiff did not yet have definite

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plans to incur them, including expenditures for experiments and innovations in its method of gathering information in order to maintain its competitive position, the relocation of part of its business premises and employees, and the redemption of minority stock of retiring or decedent employee-stockholders which might otherwise be sold to outsiders. It is further *held* that for plaintiff's fiscal year 1966, it was not formed nor availed of for avoiding the income tax with respect to its shareholders. Plaintiff is entitled to recover, and judgment is entered for plaintiff with the amount of recovery to be determined pursuant to Rule 131(c).

Taxes; income tax; accumulated earnings tax; reasonable needs of business; burden of proof.

[1] By raising the accumulated earnings tax for the first time in its answer to plaintiff's petition in this court, as an offset to an otherwise refundable income tax, defendant may have in effect deprived plaintiff of a right to which it may be entitled under Sec. 534 of the Internal Revenue Code to submit a statement to the Commissioner of Internal Revenue setting forth its reasonable business needs for its accumulated earnings and to appeal to the Tax Court where the Commissioner would have to assume the burden of proof on the reasonableness of the accumulation. Under such circumstances, it may well be that the burden of proof is nevertheless on defendant.

Internal Revenue ⟸ 1471

Taxes; income tax; accumulated earnings tax; reasonable needs of business.

[2] An approximate method for determining working capital requirements of a business is to determine the amount needed to carry on the business during a single business cycle while funds are tied up in inventories and receivables.

Internal Revenue ⟸ 407

Taxes; income tax; accumulated earnings tax; reasonable needs of business.

[3] To the extent that corporate earnings are used to acquire the assets employed in the business (by paying off the original debt therefor), they are not deemed accumulated beyond the reasonable needs of the business.

Internal Revenue ⟸ 407

Taxes; income tax; accumulated earnings tax; reasonable needs of business; legislative intent.

[4] The purpose of defining the term "reasonable needs of the business" used in Sec. 533 of the Code to include "the reasonably anticipated needs of the business" added by Sec. 537, was to mitigate the severity of the preexisting statutory restrictions so as to make clear that there is no requirement that the accumulated earnings and profits be invested immediately in the business so long as there is a reasonable indication that future needs require such accumula-

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tion, but the Congress did not mean to give taxpayers an avenue of escape from proper application of the tax by mere subjective statements of anticipated needs which could not be corroborated objectively, and by fanciful schemes.

Internal Revenue ⇐ 407

Taxes; income tax; accumulated earnings tax; reasonable needs of business.

[5] Since the accumulation of earnings beyond reasonable business needs does not in itself trigger the tax, but is only used as the basis for a rational presumption of the purpose to avoid the income tax on dividends to shareholders, it would be inconsistent with the statutory scheme to adopt a test of reasonableness which in the particular case does not help resolve the ultimate inquiry as to purpose. If the fact finder is reasonably assured that a particular accumulation is in an amount that a prudent businessman would consider appropriate to overcome various business hazards and contingencies only partially visible, the statute should not be construed to require the court to draw the inference that the corporation was motivated by the purpose of avoiding income tax with respect to shareholders because plans for use of the accumulation were not yet specific or definite.

Internal Revenue ⇐ 407

Statutes; construction and operation; legislative intent; committee reports.

[6] Excerpts from legislative committee reports are ordinarily strong evidence of congressional intent, but they should be read in proper context, and in appropriate cases they do not preclude the placing of greater weight on more persuasive evidence of the statutory purpose as a whole.

Statutes ⇐ 217.3

Taxes; income tax; accumulated earnings tax; reasonable needs of business.

[7] While the allowance of reserves for unexpected demands and unanticipated emergencies in general would blunt the edge of the accumulated earnings tax and frustrate its purpose, a contingency is a reasonable need for which a business may provide if the likelihood of the occurrence reasonably appears to a prudent businessman.

Internal Revenue ⇐ 407

Taxes; income tax; accumulated earnings tax; reasonable needs of business.

[8] In justification of an accumulation of earnings and profits for reasonably anticipated future needs of the business, subsequent events may be considered to determine whether the taxpayer actually intended to consummate the plans for which the earnings and profits were accumulated.

Internal Revenue ⇐ 407

James B. Lewis, attorney of record, for plaintiff. *Selvyn Seidel* and *Paul, Weiss, Rifkind, Wharton & Garrison*, of counsel.

James L. Malone, III, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *John E. Evans*, of counsel.

Before DAVIS, NICHOLS and KUNZIG, *Judges*.

PER CURIAM: This case comes before the court on the joint motion of the parties, filed March 18, 1976, moving that the court adopt, with modifications*, the recommended decision of Trial Judge Philip R. Miller, filed January 23, 1976, pursuant to Rule 134(h), as the basis for its judgment in this case. Upon consideration thereof, without oral argument, since the court agrees with the trial judge's recommended decision, as hereinafter set forth**, it hereby affirms and adopts the said decision, with a modification in footnote 1, as the basis for its judgment in this case. Therefore, it is concluded that the court has jurisdiction of this case and that plaintiff is entitled to recover. Accordingly, judgment is entered for plaintiff with the amount of recovery to be determined pursuant to Rule 131(c).

OPINION OF TRIAL JUDGE

MILLER, *Trial Judge:* Plaintiff sues for refund of income taxes it paid for its fiscal year ended March 31, 1966. Plaintiff incurred a loss for its 1969 fiscal year and claims the right to a loss carryback deduction for 1966. Defendant does not contest the loss carryback but asserts as a setoff defense with respect to the claimed refund that for the year 1966 plaintiff was availed of for the purpose of avoiding income tax on dividends to its stockholders and that accordingly

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*The modification requested by the parties is the deletion of footnote 1 of the trial judge's opinion relating to "burden of proof" which the parties assert is merely dicta and not an integral part of the opinion since the issue was not raised nor briefed by the parties and not a basis for the trial judge's opinion. However, the court adopts footnote 1 with a modification of its own.

**Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed January 23, 1976, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

plaintiff was liable for accumulated earnings tax for that year in an amount equal to or greater than that sought by plaintiff.

Section 531 of the Internal Revenue Code of 1954 imposes a tax on the accumulated taxable income of a corporation formed or availed of for the purpose of avoiding the income tax with respect to its shareholders by permitting earnings and profits to accumulate instead of being divided or distributed. The accumulated taxable income is defined as the taxable income for the year with certain adjustments and deductions such as dividends paid, income taxes accrued and a credit for such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business. Section 533(a) provides that the fact that the earnings and profits are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders, unless the corporation by the preponderance of the evidence shall prove to the contrary.[1]

The statutory purpose has been simply stated (*Ivan Allen Co.* v. *United States*, 422 U.S. 617, 624–25 (1975))—

> Because of the disparity between the corporate tax rates and the higher gradations of the rates on individuals,

[1] The posture in which this issue arises raises a problem with respect to burden of proof. Section 534 of the Code provides that if the taxpayer files with the Commissioner of Internal Revenue a statement of the grounds and facts upon which it relies to establish that all or part of its earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business, or if the Commissioner fails to send the taxpayer a notification of his intention to issue a notice of accumulated earnings tax deficiency so that the taxpayer may have an opportunity to file the statement in a Tax Court proceeding to set aside the deficiency, the burden of proof as to the reasonableness of the accumulation shall be on the Commissioner. By raising the accumulated earnings tax deficiency in its answer to the petition in this court as an offset to an otherwise refundable income tax (attributable to a loss carryback deduction) defendant has deprived the taxpayer of the notification, the right to file a statement and the right to go to the Tax Court where the Commissioner would have to assume the burden of proof on the reasonableness of the accumulation. It may well be therefore that under such circumstances the burden of proof would be imposed on the defendant. *Cf.* Internal Revenue Code § 7454 (relating to burden of proof of fraud in Tax Court) with *Armstrong* v. *United States*, 173 Ct. Cl. 944, 962, 354 F. 2d 274, 285 (1965); and *see also Missouri Pacific R.R.* v. *United States*, 168 Ct. Cl. 86, 91, 338 F. 2d 668, 671–72 (1964); and *Lykes Bros. S.S. Co.* v. *United States*, 198 Ct. Cl. 312, 459 F. 2d 1393 (1972). However, since plaintiff neither raised nor briefed this issue and defendant was not put on notice of having such a burden of proof in this case, the decision herein has not been arrived at on such basis.

> a corporation may be utilized to reduce significantly its shareholders' overall tax liability by accumulating earnings beyond the reasonable needs of the business. * * *
>
> In order to foreclose this possibility of using the corporation as a means of avoiding the income tax on dividends to the shareholders, every revenue act since the adoption of the Sixteenth Amendment in 1913 has imposed a tax upon unnecessary accumulations of corporate earnings effected for the purpose of insulating shareholders. [Footnotes omitted.]

During the taxable year at issue plaintiff was engaged in the businesses of measurement of radio audiences and of performing market research on a custom basis by telephone interviews. Although plaintiff was incorporated in 1962, the business actually dates back to 1936 when it was commenced by C. E. Hooper, Inc. (Old Hooper), and it was in continuous operation since that time. After the death of the founder, in September 1962, seven employees of the company and its attorney invested $100,000 in a new company, the plaintiff, and the new company purchased all of the stock of Old Hooper from Mrs. C. E. Hooper and her daughter and liquidated it so as to acquire the assets. The consideration was approximately $800,000, of which $100,000 was in cash, $500,000 was in the form of a 6-year note signed by plaintiff and personally guaranteed by its eight stockholders, and the remainder consisted of some of the assets of the corporation which were turned over to Mrs. Hooper.

Plaintiff was prohibited from paying dividends until the note was paid off. However, from its inception plaintiff prospered and was able to pay off the note in less than half its term, by September 1965.

From the start the intent of the subscribers was that ownership of plaintiff remain in the hands of persons connected with the operations of the company. The 1962 stock-subscription agreement provided that any stockholder desiring to sell his shares was required first to offer them to the plaintiff and then to the other stockholders pro rata at a price which took into account the continuing share of indebtedness to Mrs. Hooper. After the note to Mrs. Hooper had been paid off, as of December 20, 1965, the parties revised and amplified their restrictive agreement on transfer of shares to outsiders

so as to cover not only voluntary transfers but also transfers resulting from death, incompetency, insolvency, attachment, execution, etc. A stockholder desiring to dispose of his shares could require the corporation to purchase them at book value including goodwill; but if he obtained a bona fide purchase offer from an outsider which was more favorable he was required to give the corporation a first option and the other stockholders a second option to purchase either at the offer price or at a "Purchase Price Per Share", defined as the greater of (a) the average price paid per share and (b) seven times the prior average earnings, plus book value. In the event a stockholder ceased to be an employee, officer or director, or in the event of a threatened involuntary transfer, the plaintiff and its remaining stockholders were also given the same options to buy at the "Purchase Price Per Share". The price was to be paid one-sixth in cash and in five annual installments plus interest.

Subsequent to the taxable year at issue one of the employee-shareholders died, one retired and two others resigned to take positions elsewhere. Pursuant to the option agreement the corporation redeemed their shares as follows:

Amt. Pd In For Shares	Redemption Price	Difference	Redemption Date
$10,500	$91,389	$80,889	3/31/67 (deceased)
4,000	36,374	32,374	6/30/67 (retired)
10,000	99,680	89,680	12/5/67 (resigned)
7,500	78,297	70,797	5/31/68 (resigned)
$32,000	$305,740	$273,740	

The first redemption was paid in a lump sum, while the remainder was paid one-sixth in cash and the balance in five annual installments evidenced by notes.

In the performance of its services plaintiff employed a network of approximately 3,000 telephone interviewers working out of their homes in from 350 to 400 market areas throughout the United States. Except for supervisors and a few key employees in each city who were paid a monthly retainer of from $20 to $25, the interviewers were paid for hours of actual interviewing work. At the nucleus of the Hooper organization plaintiff had about 145 salaried employees. Some of these were employed in the executive and sales offices in New York City. Others were situated at a production facility in Wilton, Connecticut, where information was collected, tabulated and put into report form.

Opinion of Trial Judge

In its radio-surveying business plaintiff prepared continuous measurement of in-home radio listeners on a market-by-market basis and sent them to subscribers to its reports. More than 97 percent of its subscribers were radio stations, and the remainder were advertising agencies and advertisers. Subscribers found them useful in program evaluation and planning, and for media buying. The Hooper-Ratings method employed a coincidental telephone survey to measure radio listening. The interviewers would inquire on the telephone as to whether the respondent's radio was turned on, and if the respondent or another member of the household was listening he was asked to identify the radio station and program. Plaintiff then prepared periodic reports on listening habits in each market.

Plaintiff's marketing research work involved determination of the attitudes of consumers with respect to particular products, and how most effectively to sell to such consumers. Each research project was tailor-made to the particular client and product. It frequently involved questionnaires and precisely instructed interviewing procedures. The information was tabulated, coded, processed and compiled into a report for the particular client paying for the project. Both aspects of the business involved utilization of the same network of telephone interviewers and markets.

The principal officers during the taxable year were Frank Stisser, its president, and Bruce McEwen, its executive vice president. Both had been in similar posts in Old Hooper.

A capsulized statement of plaintiff's earnings for the fiscal years ended March 31, 1963 through 1969, its dividends, and retained earnings may be set forth as follows:

	1963 (2 mos.)	1964	1965	1966	1967	1968	1969
Net Profit or Loss	$9,990	$180,173	$172,764	$299,399	$227,019	$118,581	($58,372)
Dividends				50,000	30,000	7,595	
Net Profit or Loss to Retained Earnings	9,990	180,173	172,764	249,399	197,019	110,986	(58,372)
Charge to Earnings on Redemption of Stock						203,393	70,797
Total Retained Earnings	$9,990	$190,162	$362,927	$612,326	$809,345	$716,938	$587,769

Since through March 31, 1966, the retained earnings were for the most part used to pay off the note to Mrs. Hooper, which had been used in the bootstraps purchase of the busi-

ness of Old Hooper, plaintiff's net liquid assets or working capital was considerably below its retained earnings as of the end of each fiscal year. Such may be portrayed as follows:

	Current Assets	Less Current Liabilities	= Net Liquid Assets (Working Capital)
1963	$305,959	$163,068	$142,891
1964	467,379	293,639	173,740
1965	439,426	237,481	201,945
1966	659,164	353,782	305,382
1967	702,618	195,137	507,481
1968	629,860	116,210	513,650

From the foregoing tabulations and other financial evidence in the record various inferences may be drawn. For its fiscal year ended March 31, 1966, plaintiff's after-tax net income, $299,399, was more than 70 percent higher than in the prior year. Its operating profit for the last month of the 1966 fiscal year was 47 percent higher than the average monthly earnings for the prior 11 months. Even after payment of its first dividend, $50,000 in 1966, its books still showed $305,382 in liquid assets. Thus the financial results through fiscal 1966 show prosperous conditions and no basis for apprehension as to prospect of losses necessitating the husbanding of liquid reserves. Even for the year after the one in issue the financial statistics do not reflect a declining business. While fiscal 1967 net earnings of $227,019 were 24 percent less than in 1966, they were still higher than in any prior year, and there was no evidence of any substantial decline in its revenues, since the gross income was short of its peak by only 7 percent and net liquid assets at the end of fiscal 1967, after a $30,000 dividend, still increased to $507,481.

Plaintiff claims that the $305,382 was far less than the reserves a prudent business corporation required for its reasonable needs, both present and anticipated as of March 31, 1966. It enumerates requirements for working capital and a variety of plans and contingencies requiring the expenditure of capital. Defendant on the other hand can find a need for no more than $192,000 in working capital and deems the remainder of the $305,382 to be beyond the reasonable needs of the business.

Plaintiff claims working capital requirements as of March 31, 1966, to be $439,323. As noted above defendant's comparable figure is less than $192,000. On the basis of the

evidence and as more fully set forth in the findings, it is concluded that plaintiff's working capital needs as of the end of fiscal 1966 were $241,144.

An approximate method for determining working capital requirements based on the needs for one complete operating cycle of a business has evolved from decisions during the last 10 years beginning with *Bardahl Manufacturing Corp.* v. *Commissioner*, 24 TCM 1030 (1965). And *see also Apollo Industries, Inc.* v. *Commissioner*, 358 F. 2d 867, 871–72 (1st Cir. 1966); *Kingsbury Investments, Inc.* v. *Commissioner*, 28 TCM 1082, 1088–89 (1969); and *W. L. Mead, Inc.* v. *Commissioner*, P–H Mem. T.C. ¶ 75,215 (1975). A synopsis of the method is set forth in B. BITTKER AND J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 8–16 (3rd ed. 1971), as follows:

> The operating-cycle test, first enunciated by the Tax Court in the *Bardahl* case in 1965 and refined by later decisions, permits accumulations of current earnings to cover reasonably anticipated costs of operating a business for a single operating cycle. The length of the cycle is the period during which money is tied up in inventory or accounts receivable, and hence is unavailable for dividend distributions by the company. This cycle may be described as the time needed to convert cash into raw materials, raw materials into finished goods, inventory into sales and accounts receivable, and any accounts receivable into cash.

As Bittker and Eustice also recognize, authorities subsequent to *Bardahl* have included in the operating cycle as a factor to be subtracted in determining the taxpayer's operating capital requirements the time extended to it by its own creditors, since to the extent that payment of expenses may be postponed as a result of credit arrangements plaintiff's need for operating capital is reduced. *See Kingsbury Investments, Inc.* v. *Commissioner*, *supra*, and *W. L. Mead, Inc.* v. *Commissioner*, *supra*.

Although plaintiff did not have inventories in the conventional sense, the time required for production of its reports prior to billing may fairly be compared to the production of inventory. For its 1966 fiscal year approximately two-

thirds of plaintiff's business (as measured by gross revenue)[2] was comprised of its marketing research business. This had an average production period of approximately 45 days. The remaining one-third of plaintiff's business, the radio-survey business, was billed on the first of each month without regard to whether the work was completed or even begun. Defendant takes the view that on the average the radio work was prepaid to the extent of 10 days. On the basis of the record it cannot be told whether such work was predominantly prepaid or whether plaintiff generally used its own working capital to pay for the work during the period of its production. Accordingly, it can only be determined that on the average plaintiff required zero days of working capital for preparing the radio surveys during the production cycle. On the basis of these facts it is concluded that plaintiff's average production cycle for the combined marketing-research business and radio-survey business was approximately 30 days.

The parties are in agreement that the average time between plaintiff's posting an account receivable on its books to its collection of that account receivable (plaintiff's collection cycle) was 43.53 days.

In appraising plaintiff's own credit cycle, its expenses must be divided into three different categories: Interviewers' Salaries, Other Salaries, and Nonsalary Payables. Interviewers were paid once a month. Other salaries were paid twice a month. For the fiscal year 1966, 63.5 percent of plaintiff's expenses were for salaries. Of these approximately 28 percent were for salaries paid every 30 days, and 35.5 percent were for salaries paid every 15 days. The remaining 36.5 percent of plaintiff's expenses, for other than salary purposes, were determined by the Internal Revenue agent on the basis of his conversations with plaintiff's representatives to have a credit cycle of about 30 days. Plaintiff has not presented any evidence to contradict such determination. The net effect of the three credit periods is to attribute to plaintiff an average credit cycle for all payables of 24.7 days.

In summary, based upon plaintiff's having for its fiscal year ended March 31, 1966, a production cycle of 30 days,

[2] Plaintiff urges that the business be divided up according to costs of operation. However, the record does not fairly enable the making of such a division.

plus a collection cycle of 43.53 days, less a credit cycle of 24.7 days, it is reasonable to conclude that plaintiff had an operating cycle of approximately 48.83 days. Since plaintiff's operating expenses for the same fiscal year totaled $1,802,526, or an average of $4,938.43 per day, the amount of working capital required by plaintiff for its operating cycle of 48.83 days comes out to $241,144.

Plaintiff also claims various specific needs for its earnings as of the end of the taxable year at issue. The major difficulty in evaluating these claims is that the witnesses' recollections as to particular dates and periods of time tend to telescope. This is exacerbated by the fact that plaintiff's fiscal year ended March 31, 1966, terminated so early in the calendar year and they sometimes tended to use "1966" interchangeably. With respect to most of the items it is difficult to tell whether President Stisser and Executive Vice President McEwen were testifying with respect to their intentions, actions and discussions as of the end of fiscal 1966, or as of periods one and two years later. The difficulty is compounded by the fact that the business continued to improve through the end of fiscal 1966, so that the impending downturn was not apparent to plaintiff's management and they found no need to make definite or specific plans to improve their operations and reverse the decline by making additional capital expenditures until well after the termination of the fiscal year.

A substantially contemporaneous view of the business is obtainable not only from the financial statistics for fiscal 1966, but also from a report and analysis made by Executive Vice President McEwen to the board of directors meeting on December 16, 1965, about 3 months before the end of the fiscal year. In it he noted that the company's image continued to be excellent, its client list was wide and blue chip, its marketing-research business continued to grow, its reputation was enhanced, its sales efforts were almost nonexistent because its orders were in excess of its ability to handle them, and he also projected that, "Assuming continued good general business conditions, the outlook for the marketing research division of our company is very bright." On the other hand he noted some problem areas. Included among these was the

fact that the company was unable to handle any additional business because its production facility at Wilton, Connecticut, which tabulated the information received from the interviewing field personnel and prepared the reports, was inconveniently located at an excessive distance from New York City, so that experienced marketing research, tabulating and other competent personnel it sought to recruit did not wish to live and/or work there. To meet this need he recommended to the board consideration of the retention of some profits looking to the purchase of a small marketing research tabulation operation in New York, while retaining the experienced personnel already established and living in Wilton or nearby. He also reported a high turnover in interviewing personnel, causing the quality of the field work to deteriorate and increasing the cost of training new interviewers. For this he recommended greater time, effort and expense to be put into training, control, discipline and morale of field workers. He recommended that such steps were necessary to continue the company's dominance of the telephone-interviewing technique, or else it would be faced with serious competition.

The minutes of the December 16, 1965 board of directors meeting indicates some discussion of McEwen's report, but does not indicate that any particular action was taken thereon by the board.

Plaintiff claims that as of March 31, 1966, it had a business need for $30,000 to $40,000 to be spent to strengthen its interviewer personnel in the fields, as recommended in McEwen's report. Although the evidence shows that during the summer of 1966 plaintiff paid for 10 to 15 regional supervisors located throughout the country to come to Wilton for a week of training sessions, there is no reliable evidence as to the cost of such sessions or as to the extent to which they exceeded plaintiff's customary training and orientation costs covered by its usual overhead. Plaintiff's account entitled "Field Staff Travel" totaled $15,901 for its entire 1967 fiscal year, but this was actually $8,000 less than for the prior year. Therefore, it cannot be concluded that plaintiff had a need for the accumulation of earning reserves for such purpose as of the end of fiscal 1966.

Opinion of Trial Judge

Plaintiff claims that as of the end of fiscal 1966 it approved a $200,000 expenditure to purchase a small market research tabulating company as recommended in Mr. McEwen's report. However, nothing in the minutes indicates approval of any such plan or amount. McEwen himself testified that he knew of only two feasible prospects for purchase, that he had checked into them by the fall of 1965 and found that the first was not of sufficient quality to merit purchase, and that the owner of the second was unwilling to sell the company. Thereafter he was of the view that if the company wanted to obtain additional tabulating personnel and facilities it would have to establish them itself. Accordingly, it must be concluded that as of the end of fiscal 1966 plaintiff had no definite or specific plans to buy an independent market research tabulating company as plaintiff now claims. There is also no evidence of specific or definite plans of any sort to make capital expenditures for such a new facility.

Plaintiff asserts a need in an unspecified amount for funds to purchase the building it rented for its production personnel in Wilton, Connecticut, in order to assure retention of its trained personnel who lived in the Wilton area, and to eliminate its continuing difficulties with its landlord. The minutes of the March 5, 1966 directors meeting does record a resolution authorizing the president "to make inquiry * * * of the availability of said premises for purchase * * *." However, other evidence in the record indicates that the management of the corporation had not really made up its mind to make such a purchase. President Stisser testified that the Wilton premises were unsatisfactory because they were too far from plaintiff's New York City sales and executive offices and it took too much time to travel between the two, because it was difficult to recruit any additional personnel to work in Wilton, and because it was overcrowded and in violation of the town's zoning laws. Nine months later, at the December 1966 meeting of the board, Stisser reported that his negotiations had been unsuccessful because the owner had demanded an excessive $600,000 price. But even after the landlord had reduced his asking price to $250,000 or $300,000 and offered to lease back the basement at up to $5,000 per year, in March 1968 plaintiff still had not decided to make any such pur-

chase. Plaintiff renewed its lease of the Wilton facility until January 1969 when finally the corporation moved its production facilities from Wilton to Norwalk, Connecticut, after three of its shareholders acquired a new building for $300,000 and leased it to plaintiff subject to an expenditure by plaintiff of $150,000 for improvements. Thus, the record does not support any finding that there was any specific plan during fiscal 1966 for the corporation to acquire the Wilton building.

Plaintiff asserts that one of its reasonable needs was the accumulation of funds to change over its method of surveying radio audiences from home-audience measurement to complete-audience measurement. During calendar years 1967 and 1968 plaintiff spent about $520,000 for such purpose. This involved $250,000 for computers and related equipment and for computer programming, $208,000 in salaries and other expenses for additional research and development personnel, increased sales force, office and computer personnel, and $60,000 for additional office equipment. But to what extent did plaintiff contemplate such expenditures and how specific and definite were its plans for them in March 1966?

As already noted, plaintiff's method for radio-audience measurement was the "telephone coincidental" technique whereby an interviewer would telephone listeners in their homes and ask them as to what if any programs they and others in their homes were listening to at that time and to identify them. While the results were very accurate, it had the weakness that it only measured home listening and did not measure auto radio and portable radio audiences. With the development of transistor radios particularly, the away-from-home audience increased as a percentage of the total. A 1965 publication by a leading advertising agency, which was also a client of plaintiff, estimated that the distribution of radio listening by location was 68 percent in the home, 21 percent in automobiles and 11 percent elsewhere. A vice president of the advertising agency repeatedly cautioned Hooper's President Stisser that plaintiff would have to expand its telephone interviews to measure total radio audience in and out of the home or else lose out to its competitors. Some of plaintiff's other clients also informed it during 1965 and 1966 that they would no longer be able to justify pur-

chasing Hooper's survey unless it made drastic changes in its method so as to enable coverage of the total market.

Plaintiff had two significant competitors in the radio field, Pulse, Inc., and American Research Bureau (ARB). Pulse had been a competitor of long standing and ARB entered the field in 1965 after having been in the television-audience measuring field. Pulse used a "roster recall" method under which an interviewer personally visited the homes of the interviewees, showed them a roster of the programs of a particular day and asked them to provide information as to the programs to which they had listened. ARB used a "diary" method under which a listener would be given a diary and asked to keep it with him and record information concerning the programs to which he listened. While plaintiff was aware of the expanded radio market and the methods used by its competitors, as well as the possibility or probability that eventually it would have to do something to enable it to meet the competition, from all of the evidence it must be concluded that during that fiscal year plaintiff had not definitely decided as to whether or not and when it would change its method of interviewing from the coincidental telephone method to a total audience method, and had no specific plans for spending any substantial sums of money for that purpose. Plaintiff (and its predecessor) had had experience over the years in attempting to measure total radio audiences and was not convinced that the value of the expansion outweighed the decrease in accuracy. It found that the greater demand for the change came from the advertising agencies and their clients, while more than 97 percent of plaintiff's customers were radio stations. Plaintiff was satisfied that the radio stations still believed that plaintiff's partial radio surveys were a more accurate aid in audience measurement and in programming than the other methods, and in any event could be used in conjunction therewith. Radio stations purchasing Pulse's services also continued to buy Hooper's surveys. While ARB began to receive attention in the trade, as of March 1966 ARB was only engaged in surveying 15 to 30 markets, while plaintiff and its staff of interviewers covered 350 to 400 markets throughout the United States. Hooper also felt that there was a substantial economic difference in

favor of the Hooper method in that the Hooper surveys cost the radio stations $250 a month, while a typical ARB survey cost the client $4,000 to $5,000 each. Finally, what was most persuasive to Hooper's President Stisser that there was no immediate need to change its method of radio-audience surveying in favor of a more expensive method which would also be more costly to its customers was the fact that Hooper's income from its radio-surveying business continued to expand sharply in 1966. As Stisser put it, "We were also growing. We were very happy being the managing [*sic*, probably "measuring"] and programming tool. That was a fine business for us at that point. There was no need to change really." Indeed, plaintiff's radio-measurement business not only continued to increase through fiscal 1966 but to plaintiff's management it appeared to continue to hold up during most of the following year and, as Stisser further testified, the decline which took place in the number of plaintiff's customers "wasn't obvious until December of '66."

From the foregoing it is evident that during fiscal 1966 plaintiff had no specific or definite plans for any change in its method of radio-audience measuring which would necessitate the expenditure or accumulation of funds for future expenditure, but it also gave attention to the possibility that at some time in the future it would eventually have to make changes in its radio-audience measurement techniques which might or would necessitate substantial expenditures. As previously noted, from 2 to 3 years later it actually spent more than one-half million dollars for such purpose.

Another claimed business need was for $300,000 to improve plaintiff's marketing-research business by procuring centralized and supervised telephone interviewing quarters for its field staff in up to 10 different cities. Like its radio-audience measuring business plaintiff's marketing-research business expanded greatly from 1963 through 1966. Its fiscal 1966 gross income from that part of its business increased by 13 percent over 1965. Mr. McEwen's report to the board of directors on December 16, 1965, made three-fourths of the way through the 1966 fiscal year, stated that most of plaintiff's orders were being received without having to engage in

any sales effort. While 1967 was not equally good, the decline was only 8 percent from that peak year.

Beginning even prior to fiscal 1966 some of plaintiff's competitors in the market research-business had instituted centralized interviewing, a method whereby the telephone interviewers came to a central location and conducted their interviews under supervision, monitoring and control. In the view of the advocates of this method, although it was more costly, it offered the important advantages of greater accuracy, supervision and checking on the interviewers in the asking of sophisticated and complicated questions, and it appealed to clients who wanted to listen to the questions and answers so that they could get greater understanding of the results. A number of plaintiff's marketing-research customers also expressed interest in having their research done in this manner.

However, the matter was not new to Hooper. In 1964 it had experimentally conducted two simultaneous surveys in a single city, Indianapolis, one with the telephone interviewers at home and the other with centralized interviewing. Although it found the latter to be much more expensive, it found the results nevertheless to be the same. Plaintiff believed that the cost would be too prohibitive for the method to be economically feasible. Interviewers operating from their homes were paid only for work done and their overhead costs were minimal. Plaintiff estimated that the capital cost of setting up central facilities would be as much as $30,000 per location in each market. Moreover, there would be increased wages, continuing overhead, costs for rent, maintenance and additional supervisors, plus compensated travel time for the interviewers from their homes to the central location. It was completely unfeasible to contemplate the institution of such a system in all 350 to 400 different markets in which plaintiff had interviewers. While Mr. McEwen believed it possible to institute centralized interviewing for a minimum of 10 medium-sized cities at a $300,000 commitment, at least through the fiscal year at issue plaintiff never made any decision to do so, since, as Mr. McEwen explained, "it was a limited field for customers because of the much higher cost. Many * * * were not willing to pay the higher cost of centralized interviewing and were happy to go along

with the existing system," and it was "an open question * * * whether there would have been enough business at the higher prices necessitated by the centralized location to make it a profitable operation." Finally, he found, even the customers who were interested would not commit themselves in advance to support it financially.

The first time plaintiff actually seriously considered spending the money required for central interviewing in a minimum of 10 cities was after the close of its fiscal year 1966. A major client, Lever Brothers, found erratic results and inconsistencies among different Hooper surveys covering the same subject matter. After discussing the matters among themselves, Lever Brothers officials considered with Hooper personnel various alternative explanations, including the possibility that the quality of the interviewing might be at fault. Finally, no earlier than June 1966 Lever pinned the blame on the quality of the interviewing and concluded that for its needs supervised centralized interviewing was desirable. Plaintiff proposed to Lever Brothers setting up the centralized interviewing facilities in 10 medium-sized cities at the $300,000 cost over a 3-year period if Lever would make a financial contribution to it. However, Lever declined to subsidize the start-up costs of such a program and the matter continued under negotiation to December 1966. In March 1967, plaintiff's intentions appearing still to be ambivalent as to whether it wanted to undertake the change, Lever Brothers transferred its business to a competitor of plaintiff which was willing to set up the centralized interviewing facilities at its own initial outlay. Plaintiff did not thereafter set up such facility for any of its marketing-research clients. Under the circumstances it must be concluded that during the year in issue plaintiff had no specific or definite plans for investing in centralized interviewing facilities, nor did it set aside or accumulate funds for such a purpose.

Finally, plaintiff claims that during fiscal 1966 it decided to attempt to purchase a radio station in order to diversify its business. However, plaintiff's president conceded at trial that he first began investigating such a purchase several months after the end of the 1966 fiscal year and did not request the board of directors' approval to look into such an

acquisition until December 1966, almost 9 months after the end of the fiscal year. Plaintiff never in fact attempted to make any such acquisition.

Having examined all of the claims for specific and definite plans and found them wanting, nevertheless, it cannot be concluded that the 1966 accumulation was sufficiently beyond the needs of the business as to give rise to the statutory presumption of a tax avoidance purpose.

Plaintiff's accumulated earnings and profits as of the end of fiscal 1966 were $612,326. To the extent that they had been used to acquire the assets employed in the business (by paying off the original debt therefor), such earnings may not be deemed beyond the reasonable needs of the business. *Ivan Allen Co.* v. *United States*, 422 U.S. 617, 628 (1975); *Electric Regulator Corp.* v. *Commissioner*, 336 F. 2d 339, 344 (2d Cir. 1964). Plaintiff's remaining earnings, held in the form of liquid assets, were $305,382. Since it has been determined that plaintiff's working capital needs as of the same date were about $241,144, it retained only $64,238 in earnings in excess of its then current needs for working capital.

Plaintiff of course contends that a sum vastly in excess of the $64,238 was needed in the business for the various purposes already discussed. Defendant argues that even to the extent the asserted needs are borne out by the record they do not qualify under the statute as "reasonable needs of the business" because the anticipated uses were not sufficiently specific nor definite during fiscal 1966.

The statutory sections are drawn in general language. Section 533 provides:

> (a) Unreasonable accumulation determinative of purpose.—For purposes of section 532, the fact that the earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders, unless the corporation by the preponderance of the evident shall prove to the contrary.

For the year at issue section 537 states:

> For purposes of this part, the term "reasonable needs of the business" includes the reasonably anticipated needs of the business.

Congress added the section 537 expansion of the pre-existing language of section 533(a) in the enactment of the 1954 Code. Its committee reports stated (H. REP. No. 1337, 83d Cong., 2d Sess., A173, and S. REP. No. 1622, 83d Cong., 2d Sess., 318, 3 U.S.C. CONG. & ADMIN. NEWS 1954, 4017, 4312, 4621, 4701):

> * * * It is intended that this provision will make clear that there is no requirement that the accumulated earnings and profits be invested immediately in the business so long as there is an indication that future needs of the business require such accumulation. In any case where there exists a definite plan for the investment of earnings and profits, such corporation need not necessarily consummate these plans in a relatively short period after the close of the taxable year. However, where the future needs of the business are uncertain or vague, or the plans for the future use of the accumulations are indefinite, the amendment does not prevent application of the accumulated earnings tax.

Defendant infers from the language of these committee reports that there is in all circumstances a requirement of specificity and definiteness of plans for use of the funds and that it excludes even reasonable accumulations to meet reasonable contingencies. Such a view ignores the context of the committee reports. The restrictive language was not written to explain a loophole-closing measure but a provision which mitigated the severity of the preexisting statutory restrictions. The committees apparently felt a need to make it clear that in applying the new provision which opened the door in favor of taxpayers to a greater degree than previously they did not mean to leave it so wide open as to give taxpayers an avenue of escape from proper application of the tax by mere subjective statements of anticipated needs which cannot be corroborated objectively, and by fanciful schemes. This cautionary language with respect to a liberalization of the statute should not be raised to the level of a statutory amendment further restricting it. Had Congress intended to impose a specificity requirement in plans for the future expenditure of accumulated earnings it required little draftsmanship effort to add such language to section 533 or 537.

The Treasury Regulations do not adopt without qualification the rigid approach urged on us by defendant. While section 1.537–1(b) tracks the quoted language of the committee reports, section 1.537–1(a) also states:

> * * * An accumulation of the earnings and profits (including the undistributed earnings and profits of prior years) is in excess of the reasonable needs of the business if it exceeds the amount that a prudent businessman would consider appropriate for the present business purposes and for the reasonably anticipated future needs of the business. * * *

In applying the standards for determining whether or not the accumulations are beyond "the reasonable needs" and "the reasonably anticipated future needs" of the business, we should not ignore the fact that this in itself does not trigger the tax, but is only used as the basis for a rational presumption of "the purpose to avoid the income tax with respect to shareholders" (sec. 533). As Judge Learned Hand stated (concurring) in *Casey* v. *Commissioner*, 267 F. 2d 26, 32 (2d Cir. 1959):

> Section 532(a) was a penal statute, designed to defeat any plan to evade the shareholders' taxes, and there can be no doubt that it presupposes some deliberate purpose to do so and is not satisfied by proving that the corporation was mistaken in its estimate of its future "needs."

And *see also United Business Corp.* v. *Commissioner*, 62 F. 2d 754, 755 (2d Cir.), *cert. denied*, 290 U.S. 635 (1933). It would therefore be inconsistent with the statutory scheme to adopt a test of reasonableness which in the particular case does not help resolve the ultimate inquiry as to purpose. If the fact finder is reasonably assured that a particular accumulation is in an amount that "a prudent businessman would consider appropriate" to overcome various business hazards and contingencies which are partially visible on the horizon, it is difficult to see why the statute should be construed to require the court nevertheless to draw the inference that the corporation was motivated by the purpose of avoiding income tax on its shareholders because plans for use of the accumulation were not yet specific or definite. As the court

stated in *Electric Regulator Corp.* v. *Commissioner*, *supra*, at 346:

> Nor is it always possible for a company in advance to set aside a specific sum to achieve a specific goal. Comments made in the past to the effect that a definite plan actually followed through must be on the company's books and records before moneys assigned thereto become anticipated needs may have to be appropriately qualified in particular cases.

Legislative committee reports are ordinarily strong evidence of congressional intent, but they should be read in proper context, and in appropriate cases they do not preclude the placing of greater weight on more persuasive evidence of the statutory purpose as a whole. *Commissioner* v. *Acker*, 361 U.S. 87, 92–93 (1959); *United States* v. *Ogilvie Hardware Co.*, 330 U.S. 709, 718–19 (1947).

In the instant case we are required to evaluate the need for $64,238. This is a relatively small amount. It represents about 10 percent of accumulated earnings, 21 percent of net liquid assets, and about 4 percent of expenses for 1966.

An important point to keep in mind is that plaintiff's business was of a kind which could not reasonably be expected to remain at a fixed level without changes or improvements. Its products were not tangible but were intellectual efforts. What it offered to its clients were statistical compilations from relatively small samples of what it hoped were representative of yesterday's public habits, conduct, attitudes and opinions, and from which its clients could be reasonably satisfied they could attempt to forecast tomorrow's probabilities. The skills and arts involved were constantly subject to innovative ideas and improvements, and the competitor which could convince the clients that its methods could achieve greater accuracy at an economically feasible cost represented a constant threat. While it would be reasonable to demand evidence of specific commitment to a particular use to support an accumulation of several hundred thousand dollars, considerably less specificity should be demanded for $64,238, which at best gives only a measure of room to experiment and maneuver. A prudent businessman

in such an enterprise could be expected to retain at least that sum for such purposes.

The allowance of reserves for unexpected demands and unanticipated emergencies in general would blunt the edge of the accumulated earnings tax and frustrate its purpose. However, "a contingency is a reasonable need for which a business may provide if the likelihood of its occurrence reasonably appears to a prudent businessman". *Dahlem Foundation, Inc.* v. *United States*, 405 F. 2d 993, 1003 (6th Cir. 1968); *Smoot Sand & Gravel Corp.* v. *Commissioner*, 241 F. 2d 197, 206 (4th Cir.), *cert. denied*, 354 U.S. 922 (1957); *Duke Laboratories, Inc.* v. *United States*, 222 F. Supp. 400, 412 (D. Conn. 1963), *aff'd*, 337 F. 2d 280 (2d Cir. 1964).

The evidence reflects plaintiff's reluctance during fiscal 1966 to expand its radio surveys beyond the home audience while its earnings continued to rise; but in the light of the increasing proportion of away-from-home listeners a prudent businessman in plaintiff's position would nevertheless not have disregarded the probable need for retaining some resources in the coming years to accommodate itself to the changing market. In its brief defendant concedes that "there certainly was an impetus in fiscal year 1966 for radio-listening surveyors to gather information from the total audience market." Plaintiff's need for the accumulation is corroborated by its expenditures during the next 2 to 3 years of more than a half million dollars to enable it to provide a total radio-audience measurement service by the fall of 1968. Plaintiff did not resolve its doubts about incurring such expenditures during 1966, but the problem did not arise spontaneously thereafter. Had plaintiff not accumulated some reserves in prior years, it might have had difficulty in implementing its decision in 1968.[3]

While plaintiff never adopted centralized interviewing for its market-research business and did not have a definite plan to adopt it, the evidence does show that during or even prior to fiscal 1966 some of its clients requested it. Plaintiff did

[3] Treas. Reg. § 1.537–1(b)(2) states that, "subsequent events may be considered to determine whether the taxpayer actually intended to consummate * * * the plans for which the earnings and profits were accumulated."

evaluate its feasibility and it did make cost estimates involving a minimum of $300,000. Without a minimal reserve plaintiff could not even have considered the proposals seriously.

Again, while the record reflects that during fiscal 1966 plaintiff had no firm plan for purchasing particular real estate, it does show that plaintiff gave consideration to the alternatives of either the unsatisfactory building at Wilton, Connecticut, in order to insure retaining the corps of trained workers who lived there, or to buying other quarters closer to New York where additional skilled workers could be recruited. Although plaintiff did not arrive at a specific plan to do either during the year, the fact is that eventually plaintiff had to do one or the other. In January 1969 its shareholders acquired the new building in Norwalk, Connecticut, for $300,000 and plaintiff had to put out $150,000 for improvements. Therefore, even in the absence of a definite use for a specific amount of funds, it may reasonably be concluded that a prudent businessman in plaintiff's position would have retained at least $64,238 to enable it to undertake one or the other of these steps should the opportunity for a favorable purchase present itself.

The record also shows a preexisting policy that ownership and control of the business should, if possible, be confined to those who managed it, and therefore stockholders and the estates of decedent stockholders were required to give the corporation first option on the purchase of their shares. Since during 1966 at least the agreed option prices were at book values in excess of the amounts paid in, maintenance of such a policy dictated the retention of some earnings for this purpose lest the corporation be required to go heavily into debt. Within 1 year of the close of fiscal 1966 one minority officer-stockholder died and the corporation paid her estate $91,389 in cash, of which $80,889 necessarily came from earnings. Over a period of 26 months after fiscal 1966, plaintiff paid in cash and notes $214,351 in redemption of the shares of three retiring and resigning officers, of which $192,851 was chargeable to earnings. It is difficult to surmise that a reserve of at least $64,238 was in excess of what a

prudent businessman would retain to enable it to carry out its agreed policy.[4]

In the light of these various alternative and combined contingencies peculiar to plaintiff's business and its ownership, it is concluded herein that a prudent businessman would have considered it appropriate to accumulate aggregate earnings to meet them at least equal to the $64,238 at issue.

Finally, it is concluded that plaintiff was not availed of for the purpose of avoiding the income tax with respect to its shareholders.[5] Former President Stisser and Executive Vice President McEwen, who held the controlling interests in plaintiff, testified directly that in deciding the amount of dividends to disburse and the amount of earnings to retain for fiscal 1966 they were not motivated by any intent to avoid surtaxes. Plaintiff having been merged with a publicly held company in fiscal 1970, neither is presently employed by plaintiff or its present owner and his interest in the result of this case is relatively small, as a small minority stockholder. There was no cross examination with respect to their tax motivation in retaining the $64,238 in the business, and there is no testimony of minority stockholders or others to contradict them.

Their actions in disbursing $50,000 in dividends during fiscal 1966 and $30,000 in 1967 is certainly to some degree inconsistent with the intent to avoid surtax on themselves. Any such withholding of additional earnings for personal reasons would have been incompatible with the interests of the minority employee-stockholders owning 45.45 percent of the shares, who, judging from their salaries of from $15,250 to $24,500 were not so affluent as not to need additional income. Both Stisser and McEwen testified that they were under pressure from the minority stockholder-

[4] Accumulations for such purposes have been held to serve a business need. *Mountain State Steel Foundries, Inc.* v. *Commissioner*, 284 F. 2d 737, 743–45 (4th Cir. 1960); *Farmers and Merchants Investment Co.* v. *Commissioner*, 29 TCM 705, 711 (1970).

[5] This conclusionary finding is supported by all the evidence, even if arguendo defendant is aided by the presumption under Internal Revenue Code § 533(a) because of the absence of definite and specific plans for use of the accumulated liquid funds. *Cf. Halby Chemical Co.* v. *United States*, 180 Ct. Cl. 584, 599 (1967).

coworkers to pay additional dividends, and had they felt the business interests warranted it they would have voted to do so.

Had Stisser and McEwen been motivated in their corporate financial decisions by personal considerations, it is more likely they would have increased their salaries which were relatively small for a business earning almost $300,000 after taxes ($34,000 plus $5,100 in deferred compensation under profit-sharing plan for Stisser. and $31,500 plus $4,725 for McEwen), and which would have been deductible by the corporation in computing both income and accumulated earnings taxes.

Defendant argues that since Stisser's and McEwen's total incomes put them into the 50 and 42 percent surtax brackets in 1966, they avoided surtax by not receiving any additional dividend income at that time. (Had they distributed the entire $64,238, Stisser would have received $24,700 and McEwen $15,417.) However, the argument based on such surtax brackets is not persuasive as to their purpose. It disregards wholly the risks and disadvantages of such a course of conduct. It presupposes that in 1966 they had plans for liquidating the corporation or selling their stock in the reasonably near future so that they could obtain the earnings at capital-gain rates without exposing them to possible future business losses and without interest for the intervening period. There is no evidence of any such plan. Such a tax-saving scheme would also have had to take into account the offsetting losses of their future salaries. Furthermore, the risk of accumulated earnings taxes at 27½ and 38½ percent, the cost of possible tax litigation, and the possibility of personal liability to the corporation in a suit against them by the minority stockholders for having caused the corporation to incur an unnecessary penalty tax for their personal benefit would also have to be thrown into the balance.

For all of the foregoing reasons it is concluded that the accumulated earnings tax was not due from plaintiff for its fiscal year ended March 31, 1966, and accordingly plaintiff is entitled to the refund properly attributable to its loss-carryback deduction from 1969.

Syllabus

CONCLUSION OF LAW

Upon the findings of fact and the foregoing opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that the court has jurisdiction of this case and that plaintiff is entitled to judgment. The amount of its recovery will be determined in further proceedings pursuant to Rule 131(c).

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537 F. 2d 486

BOURNS, INC. AND MARLAN E. BOURNS v. THE UNITED STATES; ALLEN-BRADLEY COMPANY, ET AL., INTERVENORS

[No. 383-73. Decided July 9, 1976]

ON DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT AND SUPPLEMENTAL MOTION FOR SUMMARY JUDGMENT

Patents; validity; collateral estoppel; prior adjudication of invalidity.—Plaintiffs seek compensation for alleged unauthorized use by the United States of their invention described in the claims of United States Patent No. 2,777,926 relating to a leadscrew actuated potentiometer. Relying on *Blonder-Tongue, Inc.* v. *University of Illinois Foundation*, 402 U.S. 313 (1971), defendant asks that collateral estoppel be applied to all of the claims in issue, on the grounds that claims 1, 2, 11, 14, 15, 16 and 20 were declared invalid in *Bourns, Inc.* v. *Dale Electronics, Inc.*, 308 F. Supp. 501 (D. Nebr. 1969), and that while claims 3, 4, 6, 7, 12, 19, 21 and 22 were not litigated in the prior suit they present the same issues under 35 U.S.C. § 103 as those decided adversely to plaintiff's. It is *held* that despite verbal differences in the adjudicated and unadjudicated claims, issues identical to those in *Bourns* v. *Dale*, *supra*, are presented here, and that, having had their day in court on those issues, plaintiffs are collaterally estopped to relitigate those issues against defendant. Plaintiffs are not entitled to recover, defendant's motions for summary judgment are granted and the petition is dismissed.

Pleading and practice; argument before court; briefs; affidavits.

[1] Newly presented affidavits accompanying plaintiffs' brief to the court amount to a supplementation of the record made before the trial division and are generally not permitted, nor are they provided for in the Rules of the court.

Courts ⇐ 465

Syllabus

Patents; estoppel; prior adjudication of invalidity.

[2] Where there is no genuine issue of any material fact in the present suit and where plaintiffs had a full and fair opportunity to litigate validity in a prior suit, the court will apply collateral estoppel with respect to those claims previously found invalid, making summary judgment appropriate as to said claims.

Federal Civil Procedure ⇐ 2508

Patents; estoppel; prior adjudication of invalidity.

[3] It is the identity of the *issues* litigated and decided, and which are essential to the prior judgment, that determines whether the estoppel should be applied. There is no reason to employ a different approach in a patent context by looking to the claims litigated instead of to the issues that were decided. By the court focusing on the issues of fact and law necessary to a resolution of the obviousness issue, a determination can be made whether the unadjudicated claims present any new issues which, to afford due process, would require a trial on the merits, or whether litigation on those claims would simply be a repetitious lawsuit. Thus, if a patentee has once been heard on all the factual issues necessary to an obviousness determination, and that determination already has been made adversely to one claim, neither due process nor the patent statutes require that the patentee be heard once again on those same issues and same obviousness determination simply because a different claim is involved.

Judgment ⇐ 715(1)

Patents; claims; define invention.

[4] In the usual case, patent claims may be multiplied either because there are multiple facets to the invention and claims to the separate parts and subparts are necessary to protect the invention, or because it is desired to define the metes and bounds of the invention in a variety of ways.

Patents ⇐ 101(5)

Patents; claims; construing and interpreting; comparison with other claims.

[5] A domino approach in which each successively narrower claim is compared with the one before it, not with the prior art, is inappropriate since it improperly gives prior-art effect to the subject matter of an invalid claim.

Patents ⇐ 51(1)

Patents; patentability; obviousness; generally.

[6] A claim may be invalid for obviousness under 35 U.S.C. § 103 but still describe a combination not found in the prior art.

Patents ⇐ 18

Patents; validity; presumption of validity.

[7] Each claim of a patent is entitled to a presumption of validity and is to be treated as a complete and independent invention.

Patents ⇐ 32

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Patents; estoppel; prior adjudication of invalidity.

[8] In determining identity of issues bearing on validity and on the applicability of collateral estoppel, it is appropriate to compare adjudicated and unadjudicated claims, and the differences revealed thereby must be evaluated, not in terms of obviousness under a domino approach, but rather in terms of *Graham* v. *John Deere Co.*, 383 U.S. 1 (1966), issues. Where the differences revealed by such a comparison do not vary the relevant issues bearing on obviousness, collateral estoppel applies.

Judgment ⇐ 715(1)

Patents; pleading and practice; estoppel issue; burden of proof.

[9] The proponent of a collateral estoppel plea has the burden not only of establishing by a preponderance of all the evidence that identical issues are presented by the adjudicated and unadjudicated claims, but also of showing that, on a motion for summary judgment, there are no genuine issues of material fact relevant to that determination.

Federal Civil Procedure ⇐ 2544

Patents; estoppel; prior adjudication of invalidity.

[10] Where the differences between the adjudicated and unadjudicated claims relate only to things known in the prior art, or where additional elements recited in the unadjudicated claims do not distinguish the claimed combination as a whole from the prior art, the differences between the prior art and the claims presently at issue are the same as in the prior litigation.

Patents ⇐ 327(13)

Patents; estoppel; prior adjudication of invalidity.

[11] While the subject matter of a claim must be considered as a whole, validity determination necessarily focuses on the distinguishing features incorporated into the claims. Where the distinguishing features of the adjudicated and unadjudicated claims appear to be the same, and neither the text of the patent nor plaintiffs attribute any importance or significance to the additional elements added in the unadjudicated claims, further trial is not justified to afford plaintiffs, contrary to the philosophy of *Blonder-Tongue*, a second chance to litigate what they had a full and fair opportunity to do in the first suit.

Patents ⇐ 327(13)

Patents; patentability; evidence of patentability; secondary considerations.

[12] Secondary considerations, to be pertinent, must relate to the claimed contribution of the patentee, and not to other factors.

Patents ⇐ 33

Patents; patentability; evidence of patentability; commercial success.

[13] Evidence that commercial success was attributable to a capable field manager and an aggressive sales program, as well as the

Syllabus

device itself, is insufficient to establish commercial success as a relevant consideration in an evaluation of the previously unadjudicated claims here in issue.

Patents ⇐ 35

Patents; patentability; evidence of patentability; copying by industry.

[14] While plaintiffs assert that industry copied their device, to be relevant as a consideration of patentability, the comparison must be with the claims in dispute, not between competitors' devices and plaintiffs' commercial device which may or may not be covered by the patent in issue.

Patents ⇐ 35

Pleading and practice; summary judgment; when appropriate.

[15] Arguments as to secondary considerations of commercial success, long-felt need, and as to the device's advantages advanced without success in the prior litigation, which considerations and advantages are no more attributable to the combination of the unadjudicated claims here in issue than they were to the adjudicated claims, do not raise a triable issue of fact which would defeat a motion for summary judgment. A party contesting a motion for summary judgment must come forward with something more than arguments to show that there is a factual issue to be resolved.

Federal Civil Procedure ⇐ 2508

Patents; estoppel; prior adjudication of invalidity.

[16] While plaintiffs are technically correct that the claims are each directed to different combinations, when analyzed realistically this argument is an inadequate basis on which to withhold application of collateral estoppel where the substance of the adjudicated and unadjudicated claims and the issues relevant to their validity are the same.

Judgment ⇐ 715(1)

Clyde F. Willian, attorney of record, for plaintiffs. *Robert L. Harmon*, *David A. Anderson* and *Hume*, *Clement*, *Brinks*, *Willian*, *Olds & Cook*, *Ltd.*, of counsel.

Vito J. DiPietro, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Lewis T. Steadman, for the Intervenors. *Robert W. Berry*, attorney of record. *Quarles & Brady*, of counsel.

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and SKELTON, *Judge*.

PER CURIAM: This case comes before the court on plaintiffs' request, filed November 4, 1975, for review by the court of the recommended decision, filed August 1, 1975, by former Trial Judge Hal D. Cooper (since resigned to enter private practice of law), pursuant to Rules 54 and 55, on defendant's motion for partial summary judgment and defendant's supplemental motion for summary judgment. Also before the court is defendant's motion, filed December 10, 1975, to strike affidavits of Robert L. Harmon and Robert C. McColloch which comprise the Appendix to plaintiffs' brief to the court. The case has been submitted on the briefs and oral argument of counsel.

The affidavits comprising the Appendix to plaintiffs' brief amount to a supplementation of the record on review by the court which is generally not permitted and for which the Rules of the court do not provide. Therefore, defendant's motion to strike the affidavits is granted.

Since the court agrees with the recommended decision of the trial judge, as hereinafter set forth, it hereby affirms and adopts the same as the basis for its judgment in this case. It is therefore concluded that plaintiffs are not entitled to recover and defendant's motions for summary judgment are granted and the petition is dismissed.

OPINION OF TRIAL JUDGE

COOPER, *Trial Judge:* Relying on *Blonder-Tongue, Inc.* v. *University of Illinois Foundation*, 402 U.S. 313 (1971), defendant, in two separate motions for summary judgment, asks that collateral estoppel be applied to all of the claims of Bourns Patent No. 2,777,926 asserted in this case. With respect to claims 1, 2, 11, 14, 15, 16, and 20, defendant bases its plea of estoppel on the prior adjudication of invalidity of these claims in *Bourns, Inc.* v. *Dale Electronics, Inc.*, 308 F. Supp. 501 (D. Nebr. 1969). Claims 3, 4, 6, 7, 12, 19, 21, and 22 were not litigated in the prior suit, but defendant contends that they present the same issues under 35 U.S.C. § 103 as those decided adversely to plaintiffs in the *Dale* suit and that, therefore, the estoppel should extend to those claims as well.

For the reasons stated hereinafter, it is concluded that collateral estoppel does apply and that it forecloses any relief to plaintiffs in this case.

I

The Bourns patent[1] relates to a leadscrew actuated potentiometer (LSAP). A potentiometer is a device for varying the resistance in an electrical circuit. The patent discloses the objects of the invention as providing a potentiometer that (1) may be easily and accurately adjusted, (2) may be manufactured in miniature from high-quality materials, (3) is able to withstand acceleration, vibration, and extreme ranges of temperature, (4) is small in size, compact, and accurate, and (5) has novel means for mounting. The disclosed potentiometer consists of a base on which are supported an elongated resistance element, a conductor generally parallel to the resistance element, a screwshaft, and a slider with contacts. The slider is supported on the screw so that, upon rotation of the screw, the slider and its contacts move in linear fashion along the resistance element and the conductor to vary the resistance in the circuit in which the potentiometer is connected. A cap or cover supported on the base encloses the screw and slider and restrains the slider from rotation. The screw extends through one end of the base to present an external head for adjustment purposes. A pair of holes is provided in the base so that the potentiometer may be supported on parallel mounting posts that extend through the holes. A plurality of potentiometers may be assembled on the same pair of posts, each with its external screwhead similarly oriented for ease of adjustment.

The text of the patent indicates that the ease and accuracy of adjustment achieved with the disclosed potentiometer is the result of using a precision-machined rotatable screwshaft which may be adjusted by a screwdriver. The novel mount consists of the holes in the base. The patent specification does not otherwise indicate how the disclosed device achieves the claimed objectives. For example, although the patent states that several of the component parts may be made from a molded plastic material, there is nothing describing what it

[1] The Bourns patent application was filed January 12, 1953, and the patent was issued January 15, 1957.

is in the arrangement or combination of those components that permits miniaturized manufacture of the device from high-quality materials, or how the device is able to withstand extreme ranges of temperature.[2]

II

With respect to the previously adjudicated claims, plaintiffs apparently concede that they did receive a full and fair opportunity to litigate the validity issues in the *Dale* case and that the trial court did understand the technical subject matter and issues. Their only defense to the collateral estoppel plea, as applied to those claims, is the argument that it should not be applied retroactively. In support of that argument, plaintiffs have submitted the affidavit of a corporate official in which it is stated that, in reliance on the prior rule in *Triplett* v. *Lowell*, 297 U.S. 638 (1936), the appeal in the *Dale* case was dismissed and suit was filed in another jurisdiction.[3]

That same argument was rejected in *Bourns, Inc.* v. *Allen-Bradley Co.*, 348 F. Supp. 554 (N.D. Ill. 1972), and by the Court of Appeals in affirming the District Court's application of the estoppel to the previously litigated claims, 480 F. 2d 123 (7th Cir. 1973), *cert. denied*, 414 U.S. 1094.[4] The persuasive reasons stated in the opinions of those courts provide a full answer to plaintiffs' arguments and they need not be repeated here. Suffice to say, plaintiffs have cited no case in which a collateral estoppel plea has been denied retroactive application. On the other hand, a number of courts have given retroactive effect to the estoppel in the sense that

[2] The Vaughan deposition, submitted by plaintiffs, indicates that the ability to withstand temperature changes is the result of using a precious metal wire for the wire-wound resistance element. The patent discloses the wire merely as "fine resistance wire."

[3] There has been litigation on this patent since early 1957. Up to the filing of this case, a total of seven actions had been instituted on the basis of the '926 patent. An earlier Court of Claims suit was dismissed without prejudice, as was a suit against a private defendant. Two others were terminated by consent judgments and one was settled by a license agreement. Subsequent to *Dale* suit was filed in the Northern District of Illinois, *Bourns, Inc.* v. *Allen-Bradley Co.*, in which plaintiffs sought to maintain it as a class action. Failing that, plaintiffs filed four additional infringement suits in three other districts, all of which are still pending.

[4] As discussed, *infra*, the Seventh Circuit reversed the District Court's application of the estoppel to the unadjudicated claims.

the estoppel was applied on the basis of an invalidity decision rendered prior to the *Blonder-Tongue* decision. See, *e.g.*, *Technograph Printed Circuits, Ltd.* v. *United States*, 202 Ct. Cl. 867, 484 F. 2d 1383 (1973); *Blumcraft of Pittsburgh* v. *Kawneer Co.*, 482 F. 2d 542 (5th Cir. 1973); *University of Illinois Foundation* v. *Blonder-Tongue Laboratories, Inc.*, 465 F. 2d 380 (7th Cir. 1972), *aff'g*, 334 F. Supp. 47 (N.D. Ill. 1971), *cert. denied*, 409 U.S. 1061 (1972); *Monsanto Co.* v. *Dawson Chemical Co.*, 443 F. 2d 1035 (5th Cir. 1971), *cert. denied*, 405 U.S. 974 (1972); *Blumcraft of Pittsburgh* v. *Architectural Art Mfg., Inc.*, 337 F. Supp. 853 (D. Kans. 1972), *aff'd*, 459 F. 2d 482 (10th Cir. 1972). It should be noted that in *Monsanto* and *Blonder-Tongue* the estoppel plea was allowed in cases where the trial court had already held the patent *valid*, but, by retroactive application of the estoppel, an earlier invalidity determination in another court was held to be controlling.

Nor can there be any doubt that prior district court decisions are a sufficient basis for applying the estoppel. *Iron Ore Co. of Canada* v. *Dow Chemical Co.*, 177 USPQ 34 (D. Utah 1973), *aff'd*, 500 F. 2d 189 (10th Cir. 1973); *Sherman* v. *Jacobson*, 247 F. Supp. 261 (S.D. N.Y. 1965). That was also the situation in *Lucerne Products, Inc.* v. *Cutler-Hammer, Inc.*, 175 USPQ 485 (N.D. Ohio 1972), in which an appeal from the trial court's invalidity determination was voluntarily dismissed and collateral estoppel was later applied on the basis of the trial court's opinion.

Finally, with respect to plaintiffs' contention that they relied on the *Triplett* rule in dismissing their appeal in the *Dale* case, it is difficult to accept that contention for the same reasons the Seventh Circuit rejected it. The *Triplett* rule would have permitted further litigation irrespective of whether the appeal had been prosecuted so it is difficult to understand how that rule was decisive in the decision to dismiss the appeal. The clear inference to be drawn from plaintiffs' actions is that they abandoned the appeal because they did not believe it would be successful.

Where there is no genuine issue of any material fact, and applicable principles of law indicate that collateral estoppel should be applied, summary judgment is appropriate. *Jones*

v. *Zurich General Accident & Liability Ins. Co.*, 121 F. 2d 761 (2d Cir. 1941). There being no genuine issue as to any material fact, and it appearing that plaintiffs had a full and fair opportunity to litigate validity in the *Dale* suit, collateral estoppel applies and they should now be estopped to assert claims 1, 2, 11, 14, 15, 16, and 20.

III

As to the previously unadjudicated claims, defendant contends that the issues relevant to a determination of the nonobviousness of those claims are identical to the issues adjudicated in *Dale* and that collateral estoppel should apply to them as well.

In support of its contention, defendant has submitted a series of claim-comparison charts which compares each of the claims with adjudicated claim 11 and also compares claim 19 with adjudicated claim 20. With respect to the differences revealed by this comparison, defendant has submitted a number of patents to show that those differences "do not lend patentable significance," to the claimed combination and that, therefore, they do not alter the issues bearing on the obviousness determination. For example, a comparison of unadjudicated claims 3 with adjudicated claim 11 [5] reveals the same

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[5] Claim 3 provides:

"A variable resistor comprising: a housing comprising a base member and a cap; a resistance element mounted in said housing; a slider mounted in said housing; screw means engaging said slider and adapted upon turning to cause longitudinal travel of said slider, means restraining said slider against rotation; a contact member on said slider engaging said resistance element; and a pair of spaced hollow rivets, each extending through said base member and said cap and securing said cap to said base member, whereby a plurality of like resistors may be assembled upon parallel posts extending through said hollow rivets."

Claim 11:

"A variable resistor comprising: a base member having a pair of upstanding portions at opposite ends thereof; a resistance element and a conductor mounted side by side on said base member; screw means rotatably mounted between said upstanding end portions; means engaging said screw means to prevent longitudinal movement thereof while permitting rotation thereof; a slider having threaded engagement with said screw means; spring contact members carried by said slider and wiping on said resistance element and conductor; means restraining said slider against rotation, whereby turning of said screw means causes said spring contact members to travel over said resistance element and said conductor, and means for mounting said resistor, including apertures extending transversely thru said upstanding end portions of said base member to receive parallel mounting posts."

combination of elements except that claim 3 adds to the combination a cap or cover and hollow rivets in the mounting holes, the rivets securing the cap to the base. The use of covers with potentiometers is shown to be known in the art, defendant citing, for example, Patent No. 1,692,962 and Bourns' prior Patent No. 2,515,981. With respect to the hollow rivets, defendant has cited a number of prior art patents which disclose hollow rivets for securing one element to another. See, *e.g.*, Patent No. 2,721,964, in which the rivets define openings to receive mounting posts.

In opposition to the motion, plaintiffs' basic position is that collateral estoppel under *Blonder-Tongue* is only applicable to the specific claims actually litigated in the prior action. In support of that position, plaintiffs cite their own prior case, *Bourns, Inc.* v. *Allen-Bradley Co.*, *supra*, in which the Seventh Circuit reversed the District Court's application of estoppel to unadjudicated claims. Plaintiffs maintain that any application of collateral estoppel to unadjudicated claims would be contrary to the patent statute which provides that each claim of a patent is to be presumed valid and would, therefore, be a denial of due process.

Plaintiffs' position cannot be accepted for the reason that it gives too restrictive an application to the collateral estoppel doctrine. As this court stated in *Carter-Wallace, Inc.* v. *United States*, 204 Ct. Cl. 341, 348, 496 F. 2d 535, 538 (1974), in determining the applicability of the estoppel, the first consideration is "whether the issue of invalidity common to each action is substantially identical." It is the identity of the *issues* litigated and decided, and which were essential to the prior judgment, that determines whether the estoppel should be applied. That, classically, has always been the basis on which collateral estoppel has been applied. *Commissioner* v. *Sunnen*, 333 U.S. 591, 597–98 (1948); *Hilkovsky* v. *United States*, 205 Ct. Cl. 460, 504 F. 2d 1112 (1974); RESTATEMENT, JUDGMENTS §§ 68, 70 (1942).

There is no reason to employ a different approach in a patent context by looking to the claims litigated instead of to the issues that were decided. Courts have long recognized that the claims of a patent may be repeated and duplicated, varying one from the other only in certain minor details. See,

e.g., *Peerless Roll Leaf Co.* v. *H. Griffin & Sons Co.*, 29 F. 2d 646, 648 (2d Cir. 1928); *Aluminum Co.* v. *Sterling Products Corp.*, 66 F. 2d 958, 962 (8th Cir. 1933). *See, also*, A. DELLER, PATENT CLAIMS § 325 (2d ed. 1971), and cases there cited. The well-entrenched practice of presenting a multiplicity of claims of graduated breadth and different scope serves several legitimate purposes. Basically, that practice represents the patent solicitor's hope that at least some of the claims will avoid prior art of which he and the Patent Office are unaware, as well as his attempt to cover as many variations, both in the inventive concept and the environment in which that concept is used, as creative competitors may devise. MCCRADY, PATENT OFFICE PRACTICE § 77 (4th ed. 1959); ELLIS, PATENT CLAIMS § 97 (1949).

In the usual case, the claims may be multiplied either because there are multiple facets to the invention and claims to the separate parts and subparts are necessary to protect the invention, *Wm. B. Scaife & Sons Co.* v. *Falls City Woolen Mills*, 209 F. 210, 214 (6th Cir. 1913), or because it is desired to define the metes and bounds of the invention in a variety of different ways. In the former situation, the invention may vary substantively from one claim to the other, but, in the latter case, the inventive thought expressed in the claims may well be the same, with only the language used to describe it, or the background elements included in the claimed combination, being varied from claim to claim. The realities of patent practice suggest that, merely because the invention, the patentee's contribution to the art, is presented in varying language or varying combinations of elements does not necessarily mean that the issues bearing on the nonobviousness of that concept or contribution vary from one claim to the next. *See*, *Adt* v. *Bay State Optical Co.*, 226 F. 925, 934 (1st Cir. 1915). That each of several differently worded claims may present identical issues is apparent from the rather common practice of selecting representative claims and stipulating that the validity of a group of claims may be determined on the basis of the representative claims. *See*, *e.g.*, *Westwood Chemical, Inc.* v. *Owens-Corning Fiberglas Corp.*, 317 F. Supp. 201 (N.D. Ohio 1970), *aff'd*, 445 F. 2d 911 (6th Cir. 1971), *cert. denied*, 405 U.S. 917 (1972).

For the foregoing reasons, the precedent of *Bourns, Inc.* v. *Allen-Bradley Co.*, *supra*, insofar as it sets out a rule which would automatically limit collateral estoppel only to the claims actually litigated is considered to be unpersuasive and is not followed here. Rather, the correct view is believed to be that of the Sixth Circuit in *Westwood Chemical, Inc.* v. *Molded Fiber Glass Body Co.*, 498 F. 2d 1115 (6th Cir. 1974), which held collateral estoppel applicable to unadjudicated claims where it was shown that the adjudicated and unadjudicated claims presented identical issues. In reaching that conclusion, recognition is given to plaintiffs' arguments regarding due process and the further argument that each claim is to be presumed valid and treated as a complete and independent invention. However, by focusing on the issues of fact and law necessary to a resolution of the obviousness issue, *Graham* v. *John Deere Co.*, 383 U.S. 1, 17 (1966), a determination can be made whether the unadjudicated claims present any new issues which, to afford due process, would require a trial on the merits, or whether litigation on those claims would simply be "a repetitious lawsuit over matters which have once been decided." *Commissioner* v. *Sunnen*, *supra* at 599. Stated otherwise, if a patentee has once been heard on all the factual issues necessary to an obviousness determination, and that determination already has been made adversely to one claim, neither due process nor any provision of the patent statute would appear to require that the patentee be heard once again on those same issues and on the same obviousness determination simply because a different claim is involved. It is believed that a proper application of *Blonder-Tongue* should preclude just such relitigation of the issues.

Plaintiffs also argue that defendant's claim comparisons, aside from the merits, improperly treat the adjudicated claims as prior art, in an effort to show that the differences between the claims are obvious. Plaintiffs assert that each claim of a patent is entitled to a presumption of validity, that each claim is to be treated as a separate and complete invention, that the pertinent standard is as to the differences between the prior art and the claims, and that invalidity of

a claim does not transform the subject matter of that claim into prior art.

Plaintiffs' argument, so far as it goes, is clearly correct. A domino approach in which each successively narrower claim is compared with the one before it, not with the prior art, is inappropriate since it improperly gives prior-art effect to the subject matter of an invalid claim. *In re Craig and Street*, 411 F. 2d 1333, 1335 (CCPA 1969). A claim may be invalid for obviousness under 35 U.S.C. § 103 but still describe a combination not found in the prior art. Moreover, it is well settled that each claim of a patent is entitled to a presumption of validity and is to be treated as a complete and independent invention. 35 U.S.C. § 282, 288. *Leeds & Catlin* v. *Victor Talking Machine Co.*, 213 U.S. 301, 319 (1909); *E. G. Smith Industries Int'l* v. *Hughes Tool Co.*, 396 F. 2d 735, 736 (5th Cir. 1968).

However, there is nothing in any of those long-accepted principles which appears to foreclose, or is inconsistent with, a determination that the issues bearing on validity of two separate claims are substantively the same. To assess the identity of those issues, it is convenient to compare the adjudicated and unadjudicated claims. Obviousness of the unadjudicated claims not being an issue, it is clear that the differences revealed by such comparisons must be evaluated, not in terms of obviousness under a domino approach, but, rather, in terms of the *Graham* issues. Where the differences revealed by a comparison of the claims do not vary the relevant issues bearing on obviousness, collateral estoppel should apply. *Westwood Chemical, Inc.* v. *Molded Fiber Glass Body Co.*, 380 F. Supp. 517 (N.D. Ohio 1973), *aff'd*, 498 F. 2d 1115 (6th Cir. 1974).

Turning to the merits of the claim comparison,[6] defendant's presentation tends to establish that the differences between the adjudicated and unadjudicated claims relate only to things known in the art and, hence, the "differences between

[6] As the proponent of the estoppel plea, defendant has the burden not only of establishing by a preponderance of all the evidence that identical issues are presented by the adjudicated and unadjudicated claims, *Westwood Chemical, Inc.* v. *Molded Fiber Glass Body Co., supra*, but also of showing that, on this motion for summary judgment, there are no genuine issues of material fact relevant to that determination.

the prior art and the claims at issue," *Graham*, *supra* at 17, are the same as in *Dale*. In other words, that presentation indicates that the additional elements recited in the unadjudicated claims do not distinguish the claimed combination as a whole from the prior art. Indeed, plaintiffs do not contest this, making no argument at all in that respect. The features in the claims here at issue, such as the mounting arrangement and parallel posts (claims 3, 12, 21, and 22), the protruding screwhead for ease of adjustment (claim 21), the close and rapid assembly of the device (claim 22), the use of terminal connectors (claim 19), and the self-locking adjustment (claim 21), were all included in the claims litigated in *Dale*. Specifically, adjudicated claims 1, 2, 11, 14, and 15 cover the mounting holes and posts; claim 20 the protruding screwhead; claims 1, 2, 11, and 14 tne close and rapid assembly; and claims 15 and 16 the terminal connectors. The self-locking feature, which consists of the threaded support of the slider on the screw, was present in all of the previous claims. Those features are the principal ones which relate to the objects of the invention stated in the Bourns patent; the remainder, such as size, compactness, and ability to withstand temperature changes, appear to have no support in any of the claims, and plaintiffs do not contend otherwise.

There are essentially two features included in some of the claims not found in the adjudicated claims. One is the use of hollow rivets in the mounting holes to secure the cover to the base (claims 3, 6, and 12) and the other is the cooperation of the cover with the slider to restrain the slider from rotation (claims 4, 6, and 7). As noted previously, defendant has cited prior art showing these features and urges that they are of no importance to the combination as a whole. Most significantly, plaintiffs do not contest this, offering not one word that suggests that either of those features contributed in any way to any of the stated objects of the patent, or that they are in any way important to the combination set forth in the claims in which they appear. Plaintiffs' only argument is that the invention must be viewed as the overall combination and the presence of these additional elements in the claims "conclusively" establishes there are new issues.

That the subject matter of a claim must be considered as a whole is a position with which there is "no quibble." *Graham*, *supra* at 32. But the practicalities are to look to the distinguishing features incorporated into the claims and the validity determination necessarily focuses on those features. *Id.* at 34. Where, as here, the distinguishing features of the adjudicated and unadjudicated claims appear to be the same, and neither the text of the patent nor the plaintiffs here attribute any importance or significance to the additional elements included in the unadjudicated claims, it is difficult to justify a further trial merely because of the presence of those elements in the claims.

The comparison of claims 3 and 11 illustrates this point. Both claims are directed to the same combination of elements, including the mounting holes in the base; claim 3, however, adds hollow rivets in the mounting holes as an additional element in the claim. The *Dale* court concluded that it was the mounting-hole arrangement which distinguished claim 11 from the prior art and it is clear that this is one of the principal features of the patent. Yet, the *Dale* court found that to be obvious in the combination claimed. Claim 3 presents the question of whether that same mounting arrangement in the same combination of elements raises a new issue simply because hollow rivets are now included in the combination. Defendant has cited a number of patents disclosing electrical components connected by hollow rivets with mounting posts extending through the rivets. While plaintiffs, on the other hand, would apparently say that the rivets raise a new issue, there is not even an argument directed to the hollow rivets, much less a substantive showing, that this is so. Based on defendant's showing, the conclusion is inescapable that the use of hollow rivets does not distinguish the claim from the prior art and that if there is anything nonobvious in the combination, it must reside in the concept of mounting holes in the base of a potentiometer. Since the *Dale* court has already considered that concept and declared it to be obvious, further consideration of the obviousness or nonobviousness of the mounting arrangement, albeit in combination with hollow rivets, would afford the patentee, contrary to the

philosophy of *Blonder-Tongue*, a second chance to litigate what he had a full and fair opportunity to do in the first suit.

The comparison of claims 4 and 11 further illustrate how, notwithstanding differences in language and elements, identical issue are presented. Both claims [7] specify the same combination of elements; however, claim 4 is somewhat more specific in that it describes the base member as being of molded plastic with longitudinal grooves and specifies the cap as the means for restraining the slider against rotation. Thompson Patent No. 1,692,962 (a patent also considered in *Dale*) clearly discloses the well-known feature of a cap restraining the slider of a screw-actuated potentiometer, while Bourns' prior Patent No. 2,515,981 discloses a base with longitudinal grooves. Once again, plaintiffs offer not one word of argument that any of these features is of any significance or importance, it appearing that it is the leadscrew actuated feature present in both claims that plaintiffs consider to be the important contribution to the art. The *Dale* court expressly considered that feature, concluded that it was known in the art, that it did not distinguish claim 11 from prior art, and that the combination, which included a leadscrew actuator, a base member, and means for restraining the slider, was an obvious one.

Merely because claim 4 describes the base as being of plastic with grooves, and designates the restraining means as the cap, all of which are known in the art, does not appear to raise any new issues with respect to the leadscrew actuator, or the patentability of the combination in which it is used. That is particularly so when neither the patent nor the plaintiffs attribute any significance to the additional limitations included in claim 4. Hence, it appears that any inquiry into

[7] Claim 4 provides:

"A variable resistor comprising: a base member of molded plastic material; said base member having a pair of parallel longitudinal grooves therein and a pair of spaced upstanding portions; a resistance element mounted in one of said grooves; a conductor mounted in the other of said grooves; screw means mounted between said spaced portions; means engaging said screw means to prevent longitudinal movement thereof while permitting rotation thereof; a slider having a threaded engagement with said screw means; spring contact members carried by said slider and engaging said resistance element and conductor; and a cap mounted on said base member, enclosing said resistor and restraining said slider against rotation whereby turning of said screw means causes said spring contact members to travel over said resistance element and said conductor."

the validity of claim 4 would simply be relitigation of the same issues already decided adversely to the patentee and would be a transparent attempt to overturn the prior obviousness determination. That is improper and collateral estoppel is applicable under such circumstances. *Cf. Seminole Nation of Oklahoma* v. *United States*, 203 Ct. Cl. 637, 646, 492 F. 2d 811, 816 (1974).

Another aspect of plaintiffs' argument relates to the secondary considerations recognized as relevant in *Graham*. A substantial portion of their brief is devoted to extolling the virtues of a commercial device identified only as the "Bourns LSAP." A number of affidavits have been presented in which the Bourns LSAP is described as a "significant and valuable contribution," "a substantial contribution to the art," and an innovation of "extraordinary value." These affidavits, and supporting documentary evidence, tend to establish that the Bourns LSAP satisfied a long felt need for a suitable trimming potentiometer of minature size that would retain its setting (the so-called self-locking feature) under adverse conditions. Further, this evidence tends to support the conclusion that the Bourns LSAP has been a clear commercial success, that it has been imitated and copied by those throughout the industry, and that it has revolutionized the market for devices of this kind.

After full consideration of this evidence, it is concluded that it does not provide an adequate basis for denying the estoppel plea. There may well be situations where, even if identical claims are involved, secondary considerations not available in the first suit will lead to the determination that an estoppel plea should be denied. *Cf. In re Herr*, 377 F. 2d 610 (CCPA 1967). But this is not such a case. In the first place, plaintiffs have inadequately identified the Bourns LSAP so that a determination can be made as to whether that device is the same as that disclosed in the patent and set forth in the claims here in issue. While it may be inferred from the affidavits that it is of the same general type shown in the patent, it is axiomatic that secondary considerations, to be pertinent, must relate to the *claimed contribution* of the patentee, and not to other factors. *Jacobson Brothers, Inc.* v.

United States, 206 Ct. Cl. 518, 512 F. 2d 1065 (1975); *Palmer* v. *United States*, 191 Ct. Cl. 346, 423 F. 2d 316 (1970), *cert. denied*, 400 U.S. 951. Plaintiffs have made almost no showing in that respect.[8] The same problem exists with the affidavits plaintiffs have presented. Although laudatory in nature, not a single one of these affidavits describes the device to which the praise is directed any more specifically than "the Bourns LSAP." Most critically, none of the affidavits attempts to relate any specific portion or aspect of the "Bourns LSAP" to any particular desirable result so that a determination could be made as to whether the result is achieved by the combination set out in the *claims*.

With respect to specific advantages, plaintiffs urge that the attributes of size, resolution, and stability possessed by the Bourns LSAP met a long felt need in the industry. While that argument may be accepted as correct, plaintiffs have pointed to nothing in the claims from which it might be concluded that it was the *claimed combination* that permitted attainment of those desirable goals. Nor is there any suggestion that these results are achieved by the combination in the unlitigated claims but were not achieved by the combination of the litigated claims.

The same is true of the contention that the Bourns LSAP succeeded where others failed. Plaintiffs have submitted a list of 29 prior patents which allegedly sought, unsuccessfully to achieve the results attained by the LSAP; however, not a single one of those patents has been submitted to the court, so the argument, insofar as it is based on these patents, remains nothing more than that. While the affidavits do tend to support plaintiffs' argument, no effort has been made to demonstrate that it was the particular combination claimed

[8] The Vaughan deposition illustrates the difficulty with plaintiffs' presentation. Vaughan testified at some length regarding a device identified as "Plaintiffs' Exhibit 238." That exhibit was not made of record in the deposition and has not been presented to the court so its substance cannot be ascertained. Upon re-direct, the following testimony was elicited:

"Q. Just so that we are clear on the subject, Mr. Vaughan, when you were referring to the sales for the Trimpot Division, were you referring to the sales of leadscrew actuated potentiometers as exemplified by Plaintiffs' Exhibit 238, which I showed you?

"A. Yes, I was talking solely about leadscrew actuated potentiometers, *not necessarily that model, but as a general class of product, that is what I was talking about.*" [Emphasis supplied.]

that had anything at all to do with Bourns succeeding where others failed.

As to commercial success, the deposition of Mr. Vaughan, plaintiff's former sales manager, indicates that it was attributable to a number of factors which included a capable field manager and an aggressive sales program, as well as the device itself. This is insufficient to establish commercial success as a relevant consideration in an evaluation of the claims here in issue. *Ellicott Machine Corp.* v. *United States*, 186 Ct. Cl. 655, 667–68, 405 F. 2d 1385, 1391 (1969).

Plaintiffs' showing that the industry copied the Bourns LSAP suffers from the same problem. The comparison, to be relevant, must be with the claims in dispute, not between competitors' devices and plaintiffs' commercial device which may or may not be covered by the patent. *Cf. Hartford Empire Co.* v. *Obear-Nester Glass Co.*, 39 F. 2d 769, 771 (8th Cir. 1930); *General Electric Co.* v. *Hygrade Sylvania Corp.*, 61 F. Supp. 476, 485 (S.D.N.Y. 1944). Plaintiffs' comparison of the dimensions of various commercial devices, for example, simply has no relevance to the issues here when the claims are not at all concerned with dimensions.

The depositions of Vaughan and Harrison are the only substantive showings which link any of the secondary considerations urged by plaintiffs with any of the elements found in the claims. Harrison testified that the threaded screwshaft on which the slider was supported was the "main feature" of Bourns' device and that it was this feature which provided adjustability and resistance to shock and vibration. Vaughan testified that the adjustability and friction of the leadscrew were advantages of the Bourns LSAP. It is noted, however, that the *Dale* court not only considered this feature but did so in light of what it described as the great commercial success of plaintiffs' device. Hence, to the extent this evidence establishes secondary considerations pertinent to an element of the claimed combination, it still does not raise any issue different from that already decided in *Dale*.

The fact is that the considerations of commercial success and long felt need, and the advantages of greater accuracy, resistance to vibration, size, configuration, adjustability, and

self-locking were all urged in the *Dale* case but to no avail, in part due to a failure to relate them to the claimed combination. See, *e.g.*, 308 F. Supp. at 505, 506. Having failed there, and having made little effort to do so here, it rather clearly appears that these considerations and advantages were no more attributable to the combination of the unadjudicated claims than they were to the adjudicated claims. Accordingly, it is concluded that plaintiffs' arguments regarding the secondary considerations do not raise triable issues of fact which would defeat a motion for summary judgment.[9]

After reviewing the entirety of plaintiffs' presentation, and eliminating for lack of demonstrated relevance the arguments regarding the advantages and secondary considerations, plaintiffs' only basis for opposing the estoppel is the argument that the claims present a combination of elements different from the combination contained in the adjudicated claims. Pertinent to that argument, unsupported as it is by a factual showing, is the statement in *Ashe* v. *Swenson*, 397 U.S. 436, 444 (1970), where it was said that collateral estoppel "is not to be applied with the hypertechnical and archaic approach of a 19th century pleading book, but with realism and rationality." Here, plaintiffs are technically correct that the claims are each directed to different combinations, but when analyzed realistically, the substance of the adjudicated and unadjudicated claims must be viewed as the same and the issues relevant to their validity are the same. Accordingly, plaintiffs' argument, standing alone in the face of defendant's showing, is simply an inadequate basis on which to withhold application of the estoppel.

IV

The Supreme Court has observed that, in the end, application of the estoppel "will necessarily rest on the trial court's sense of justice and equity." *Blonder-Tongue*, *supra*, 402 U.S.

[9] It is, of course, settled that a party contesting a motion for summary judgment must come forward with something more than arguments to show that there is a factual issue to be resolved. *Hartwig* v. *United States*, 202 Ct. Cl. 801, 810–11, 485 F. 2d 615, 620–21 (1973). A party cannot hold back its evidence for trial. *Engl* v. *Aetna Life Insurance Co.*, 139 F. 2d 469, 473 (2d Cir. 1943).

at 334. In the circumstances of this case, I am satisfied that it is just and equitable to allow the plea of estoppel here.

The *Dale* suit was in a forum and against a defendant of plaintiffs' own choosing. The claims at issue in that case squarely presented the features of Bourns' potentiometer bearing on the stated objects of the invention as set out in the patent. In particular, the leadscrew actuated feature, in combination with the base, cover, resistor, slider, contacts, and terminal leads, was present in almost every claim litigated and the mounting arrangement was present in many of those claims. In support of the validity of the claims in *Dale*, plaintiffs urged, unsuccessfully, virtually all of the secondary considerations, as well as, the advantages, argued here,[10] so not only was the substance of the patentee's contribution considered on its merits, it was evaluated in light of the relevant secondary considerations.

None of the other traditional factors that normally obviate the estoppel, see, *Hilkovsky* v. *United States*, *supra* at 464–66, 504 F. 2d 1113–114, are present in this case. Plaintiffs concede they had a full and fair opportunity, procedurally, substantively, and evidentially, to litigate validity in the *Dale* case and they offer nothing to suggest any lack of incentive to press that litigation. As the Seventh Circuit observed:

> The Dale litigation was pending for seven years in a jurisdiction with no backlog; the trial itself lasted six days and produced a transcript of 610 pages; and the potential recovery was over $1,000,000. Thus, appellants had ample incentive to litigate the case to the end. [*Bourns, Inc.* v. *Allen-Bradley Co.*, *supra*, 480 F. 2d at 126.]

[10] Plaintiffs do contend that much of the evidence in support of these considerations was newly discovered in the litigation subsequent to *Dale*. That contention was rejected by both the District Court and the Seventh Circuit in *Bourns, Inc.* v. *Allen-Bradley Co.*, 348 F. Supp. 554, 557–58 (N.D. Ill. 1972), *aff'd*, 480 F. 2d 123 (7th Cir. 1973), and it has a hollow ring here. The assertion is unsupported by affidavit or other proof. *Dale* was tried in 1969; plaintiffs' presentation here indicates that their device was on the market by 1953, that competitors started copying as early as 1955, and that litigation has been in progress since 1957. It simply cannot be accepted that plaintiffs, prior to the *Dale* trial, did not know, for example, that their device was being copied, or that commercial success was being experienced, or that there was a long felt need in the industry.

Opinion of Trial Judge

Finally, plaintiffs' presentation indicates that some 18 competitors have leadscrew actuated potentiometers which, in plaintiffs' words, are "slavish imitations" of the Bourns device. One of those is the potentiometer marketed by Dale Electronics and which formed the basis of the *Dale* litigation. Having had an opportunity to litigate the culpability of Dale for its alleged copying and infringement, and having been unsuccessful, neither justice nor equity would seem to require that plaintiffs be afforded a further opportunity to continue the battle with the other 17 competitors through the mechanism of a suit against their customer, the United States. Rather, justice and equity would seem to suggest that, one of the 18 manufacturers having been judicially declared to be free to compete without liability to plaintiffs, the time and expense of a full-blown infringement trial should not be required before the other 17 makers of essentially the same thing should be permitted to occupy a similar competitive position. Of course, no broad rule covering such situations can be formulated and there may be circumstances where further litigation would be appropriate; nevertheless, to justify such litigation, in light of the goals and objectives of *Blonder-Tongue*, it should require something more substantial than a technicality that different claims are being asserted.

It is concluded that, despite verbal differences in the claims, issues identical to those in *Dale* are presented here and that, having had their one day in court on those issues, plaintiffs should now be collaterally estopped to relitigate those issues against defendant.

Defendant's motions for summary judgment are granted and the petition is dismissed.

CONCLUSION

Upon the foregoing opinion, which is made a part of the judgment herein, the court concludes as a matter of law that plaintiffs are not entitled to recover and the petition is dismissed.

CONGRESSIONAL REFERENCE

(The following Reports were filed pursuant to the Act of October 15, 1966, 80 Stat. 958, providing for the reporting of congressional reference cases by commissioners of the Court of Claims)

DATRONICS ENGINEERS, INC. v. THE UNITED STATES

[Cong. Ref. No. 8–72. Filed June 22, 1976 and August 25, 1976]

REPORT TO THE UNITED STATES SENATE

Congressional reference; contracts; losses incurred under subcontracts; comity; equitable claims; standard of review of trial commissioner's factual determinations.—By S. Res. 357, 92d Cong., 2d Sess., Senate Bill 3953 was referred to the Chief Commissioner for proceedings in accordance with 28 U.S.C. §§ 1492 and 2509. Senate Bill 3953 provides that the Secretary of the Treasury should pay to claimant "$2,000,000 representing losses incurred by such firm under its subcontracts with Hardeman-Monier-Hutcherson, an American-Australian joint venture," which had a fixed-price contract with the United States Navy for construction of a radio communications facility at North West Cape, Western Australia. The Bill also provides that privity of contract shall be no bar to payment of the sum specified. Facts regarding performance under the contract have been detailed in previous decisions, both in this court and before the ASBCA, as follows: *Concrete Ind. (Monier), Ltd.* v. *United States*, 205 Ct. Cl. 811 (1974) (Cong. Ref.); *Hardeman-Monier-Hutcherson* v. *United States*, 198 Ct. Cl. 472, 458 F. 2d 1364 (1972); ASBCA proceedings: 69–1 BCA ¶ 7725; 68–2 BCA ¶ 7219; 68–2 BCA ¶ 7220; 68–2 BCA ¶ 7400; 67–2 BCA ¶ 6522; 67–2 BCA ¶ 6573; 67–1 BCA ¶ 6158; and 67–1 BCA ¶ 6210. Claimant's subcontracts were for assembly and erection by August 1, 1965 of a complete antenna system, comprising a center tower with 12 smaller surrounding towers and a "top hat" antenna. Timely erection of the center tower was important to the successful completion of the entire project. From the beginning major costly delays to the start of tower erection were encountered, none of the delays being claimant's fault. During the delay period claimant was forced to maintain some, and later all, of its personnel and equipment at the jobsite because commencement of work was uncertain. Claimant began actual tower erection on May 25, 1965

and continued until October 29, 1965 when its crews refused to proceed due to nonpayment of wages. Claimant advised the prime contractor that it would resume work as soon as certain progress billings were paid; on November 3, the prime took over all of claimant's equipment and completed erection of the towers. Claimant contends that its subcontracts were wrongfully terminated and that defendant directly, in concert and/or as a co-conspirator with the prime, was responsible for the wrongful termination, and that defendant mismanaged the entire project as a result of which claimant suffered damages for which it seeks compensation. Claimant's damage claim consists of "actual damages," alleged loss of profits, and an amount characterized as a loss of earnings during 1966–1971 based on damage to its business reputation and its inability to obtain bonding; the total claim is for $2,594,095. Defendant, *inter alia*, contends that claimant is foreclosed from recovery by reason of a judgment entered by the Supreme Court of Western Australia dismissing a suit claimant brought against the prime contractor. It is *concluded* (1) that the said prior judgment should not serve as a bar to the present congressional reference; (2) that, after consideration of the contention of mismanagement and the testimony of witnesses and documentary evidence, the record is barren of any substantial evidence to support the theory of mismanagement by defendant, and accordingly claimant is not entitled, either legally or equitably, to an award based on such theory; (3) that termination of the subcontracts was not justified at the time, a combination of factors contributing to claimant's failure to complete the work, including withholding of progress payments which resulted in nonpayment of wages; (4) that defendant's participation in the termination was such that, as a matter of equity and good conscience, defendant must share responsibility therefor; (5) that claimant's claim to lost profits is too speculative, and any payment on a theory of lost profits would be a gratuity; (6) that the claim for loss of earnings is without merit since claimant has not shown, by credible evidence, that there was any capital relation between termination of its subcontracts and injury to its credit and/or reputation; (7) that the evidence is not such that any determination can be made as to the out-of-pocket costs incurred in preparation for performance, nor is there any way to determine whether claimant received, through progress payments, less than the value of the work actually performed; and (8) that claimant's net amount of recovery for "actual damages" computed on a modification of the total cost theory is $23,752. On June 22, 1976 the Review Panel filed a report to the United States Senate affirming and adopting the trial commissioner's report as the basis for its said report to the Senate that claimant has an equitable, but not a legal, claim against the United States in the amount of $23,752, but not a larger amount. The Review Panels' order of July 23, 1976 denying defendant's motion for reconsideration, and its Supplemental Report

to the Senate filed August 25, 1976, both relating to the standard of proof required for review by the Review Panel of the trial commissioner's factual determinations, i.e. "clearly erroneous" v. "preponderance of the evidence" standards, are reported *in toto* following these headnotes.

Judgments; former adjudication; comity.

[1] While courts of the United States will, under appropriate circumstances, accord full faith and credit to a foreign judgment, cases of that class are distinguishable from the situation here where it is a stranger to the foreign judgment that seeks to use that judgment as a shield against further litigation. Normally, the requirements of collateral estoppel must be met before a stranger to a prior proceeding may benefit from that proceeding. Where the foreign court made no substantive findings of fact and it is not clear which issues were adjudicated or which defenses were sustained or rejected, and where claimant's absence from the foreign trial was excusable, the foreign judgment does not serve as a bar to the present proceedings.

Congressional reference; equitable claim; what constitutes.

[2] Where defendant saw a benefit to be derived by having subcontractor-claimant removed from the subject project, the benefit being expediting of work on the subcontracted increment of the project, and defendant took action through reassurances and encouragement to the prime contractor to secure that benefit, on broad equitable considerations that benefit should not be at claimant's expense where the record indicates that the termination of the subcontracts was not justified at the time. Under such circumstances, claimant has a claim against defendant for its role in the subcontracts termination.

Contracts; damages; measure of damages; total cost theory; when applicable.

[3] While, in a fixed-price contract, there is no assurance of recovery of costs, and a contractor must assume the risk of recovery, under the circumstances present in this case, particularly in view of the long delay encountered and the unjustified termination of claimant's subcontracts, claimant's approach in computing its actual damages on a modification of the total cost theory by subtracting its total receipts from its total costs, the difference being claimant's so-called "unrecovered costs," is not an unfair one and is appropriate here.

Congressional reference; pleading and practice; review of factual determinations of trial commissioner; standard of review for Review Panel.

[4] The Chief Commissioner by General Order of September 1, 1969, made Court of Claims Rule 147(b), which accords a presumption of correctness to the trial commissioner's findings of fact, applicable to congressional reference cases, and by an order dated August 17, 1976 the Chief Commissioner instructed the present review panel that said General Order should be construed as requiring the re-

view panel to preponderate the evidence in review of the findings of fact of the trial commissioner in the present congressional reference case.

[The opinion of the Trial Commissioner filed September 23, 1975 and the Report of the Review Panel filed June 22, 1976 are not reproduced.]

ORDER DENYING DEFENDANT'S REQUEST FOR RECONSIDERATION

Filed July 23, 1976

Sylman I. Euzent, attorney of record for plaintiff.
Francis L. Nunn, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before WHITE, *Presiding Commissioner of the Review Panel*, BERNHARDT and MILLER, *Commissioners*.

Consideration has been given to the request which the defendant filed on July 6, 1976, and which asks the review panel to amend its report dated June 22, 1976, by substituting "a party seeking to secure the reversal of a determination made by a trial commissioner in such a case has the burden of establishing that the determination is not supported by a preponderance of the evidence" [1] for the following statement appearing on page 2 of the review panel's report:

> * * * a party seeking to secure the reversal of a determination made by a trial commissioner in such a case has the burden of establishing that such determination is clearly erroneous. It is not sufficient to show that the record would justify some alternative determination.

It is appropriate to note that although the defendant requests a modification of certain language used in the review panel's report, the defendant's motion states that "defendant is content to rest with" the result reached by the review panel

[1] The word "not" was omitted from the defendant's request, apparently through inadvertence.

in its report. Hence, no change is sought in the review panel's ultimate advice to the Senate.

The review panel does not regard the standard proposed by the defendant as appropriate for application in congresional reference cases. Statements by the Court of Claims to the effect that factual determinations by commissioners (trial judges) will be overturned by the court if such determinations are not supported by the weight or the preponderance of the evidence (*e.g.*, *Miller* v. *United States*, 168 Ct. Cl. 498, 501, 339 F. 2d 661, 662 (1964); *Bringwald* v. *United States*, 167 Ct. Cl. 341, 347, 334 F. 2d 639, 643 (1964); and dissenting opinion by Judge Davis in *Hebah* v. *United States*, 197 Ct. Cl. 729, 753, 456 F. 2d 696, 710, *cert. denied*, 409 U.S. 870 (1972)), all relate to the performance by commissioners of functions under 28 U.S.C. § 2503. That section authorizes commissioners to perform limited judicial functions in connection with the handling of cases in the constitutional sense. As commissioners are not constitutional judges, they are only authorized to "report findings of fact" to the court, and to submit to the court "recommendations for conclusions of law." The findings of fact which they report, and the conclusions of law which they recommend, have no judicial force and effect unless and until they are adopted by the court, which is composed of constitutional judges charged by 28 U.S.C. § 175(c) with the duty to determine the facts and the law in cases subject to the court's jurisdiction.

Trial commissioners have an entirely different status in the handling of congressional reference cases under 28 U.S.C. § 2509. In that situation, Congress has provided as follows:

> (c) The trial commissioner to whom a congressional reference case is assigned by the chief commissioner shall proceed in accordance with the applicable rules *to determine the facts* * * *. He shall append to his findings of fact *conclusions sufficient to inform Congress* whether the demand is a legal or equitable claim or a gratuity, and the amount, if any, legally or equitable [sic] due from the United States to the claimant. [Emphasis supplied.]

Thus, in a congressional reference case, Congress has vested in a trial commissioner the statutory authority to *determine* facts and to append his conclusions drawn from

such facts, as distinguished from reporting facts and recommending conclusions to the court for adoption or rejection. Of course, the findings and conclusions of a trial commissioner in a congressional reference case are subject to review by a review panel, but the latter performs only a review function. In view of the statutory language quoted in the preceding paragraph, it is believed that the relationship between a trial commissioner and a review panel in a congressional reference case is more nearly comparable to that between a district judge and a Court of Appeals than it is to the relationship between a commissioner and the Court of Claims under 28 U.S.C. § 2503.

The defendant's motion quotes the following statement made by another review panel in a footnote (*Burt* v. *United States*, 199 Ct. Cl. 897, 901 (1972)):

> [3] Claimants err in contending that this court's Rule 147(b) requires affirmance of a trial commissioner's factual determination unless they are found to be "clearly erroneous." *Cf.* Rule 52(a), Fed. R. Civ. P. Though Rule 147(b) in terms accords presumptive correctness to the trial commissioner's findings of fact, such findings will only be adopted on review if supported by a preponderance of the evidence [citing cases].

The cases cited in the *Burt* footnote involved factual findings reported by commissioners to the Court of Claims in accordance with 28 U.S.C. § 2503. As indicated previously in this opinion, a commissioner's role in reporting findings of fact to the court for determination by the latter is entirely different from a trial commissioner's function of *determining* facts in a congressional reference case under 28 U.S.C. § 2509(c). This difference was not discussed in the *Burt* footnote. Also, although the chief commissioner has made the court's Rule 147(b)—which states that the findings of fact made by a commissioner (trial judge) shall be presumed to be correct—applicable to congressional reference cases, there is nothing to indicate that the chief commissioner intended for a review panel, in exercising its purely review function, to apply to a trial commissioner's factual determinations the same standard that would be applied by the Court of Claims in considering factual findings reported to the court by a commissioner for determination by the court.

As previously stated in this opinion, the present review panel believes that the relationship between a trial commissioner and a review panel is more nearly comparable to that between a district judge and a Court of Appeals than it is to the relationship between a commissioner and the Court of Claims under 28 U.S.C. § 2503. Accordingly, it is our opinion that, in reviewing the factual determinations of a trial commissioner in a congressional reference case, it is more appropriate for a review panel to apply the "clearly erroneous" standard (see FED. R. CIV. P. 52(a)) than it would be to apply the "preponderance of the evidence" standard proposed by the defendant.

With respect to the "clearly erroneous" standard, review panels may appropriately be guided by what the Supreme Court has said in *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100, 123 (1969):

> In applying the clearly erroneous standard to the findings of a district court sitting without a jury, appellate courts must constantly have in mind that their function is not to decide factual issues *de novo*. The authority of an appellate court, when reviewing the findings of a judge * * *, is circumscribed by the deference it must give to decisions of the trier of the fact, who is usually in a superior position to appraise and weigh the evidence. The question for the appellate court under Rule 52(a) is not whether it would have made the findings the trial court did, but whether "on the entire evidence [it] is left with the definite and firm conviction that a mistake has been committed" [citing *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395 (1948), and other cases.]

IT IS THEREFORE ORDERED that the defendant's request for reconsideration shall be, and it is hereby denied.

Filed August 25, 1976

SUPPLEMENTAL REPORT TO THE UNITED STATES SENATE

BY THE REVIEW PANEL: The Chief Commissioner, in an order dated August 17, 1976, instructed the review panel that Court of Claims Rule 147(b), as adopted for congressional refer-

ence cases by the Chief Commissioner's General Order of September 1, 1969, should be construed as requiring "the review panel to preponderate the evidence in review of the findings of fact of the trial commissioner in this Congressional reference case"; and the Chief Commissioner directed the review panel to reconsider its report of June 22, 1976, in the light of such construction.

It is concluded, upon reconsidering the case in the light of the standard prescribed by the Chief Commissioner, that the parties have failed to meet their burden of establishing that the trial commissioner's determinations to which they respectively object are contrary to the preponderance of the evidence. This has been conceded by the Government, which stated in its motion of July 6, 1976, that "defendant is content to rest with" the result reached by the review panel in the report of June 22, 1976, although the Government argued in the motion that the "preponderance of the evidence" standard should have been applied by the review panel. The plaintiff, in its response of July 19, 1976, also expressed satisfaction with the result reached by the review panel in the original report.

Therefore, it is not a matter of any practical importance in this case whether the trial commissioner's determinations are reviewed on the basis of the "clearly erroneous" standard mentioned in the original report or on the basis of the "preponderance of the evidence" standard prescribed by the Chief Commissioner for retroactive application. In any event, the review panel affirms and adopts the trial commissioner's report and advises the Senate that Datronics Engineers, Inc., has an equitable, but not a legal, claim against the United States, and that the amount equitably due the claimant from the United States is $23,752.

EDWARD WHITE RAWLINS v. THE UNITED STATES

[Cong. Ref. No. 1-69 Filed June 29, 1976]

SUPPLEMENTAL REPORT TO THE UNITED STATES SENATE

Congressional reference; military pay claim; constructive retirement date; measure of recovery; duty to mitigate; attorney fees and

expenses; annuity election.—In *Rawlins* v. *United States*, 197 Ct. Cl. 972 (1972), the Review Panel concluded that claimant had an equitable, but not a legal, claim against the United States, that he had suffered non-promotion to the grade of captain as a probable consequence of improper and inequitable actions within the Department of the Navy, and that there was equitably due him a retroactive promotion to the grade of captain in the active list of the Regular Navy as of July 1, 1947, and retroactive retirement in that grade as of July 1, 1951 (when claimant actually retired after more than 27 years of active service in the grade of commander). Plaintiff filed a motion for relief from the opinion, contending that he should be entitled to a "constructive" retirement date of June 30, 1955, at which time his active duty would have ceased but for the improper and inequitable action within the Navy Department. The case was remanded to the trial commissioner to determine the appropriate retirement date to be used, the correct amount equitably due claimant, and the effect of offsets for any interim earnings during claimant's constructive service as a captain. On December 1, 1975 the trial commissioner filed a recommended opinion and findings of fact which the Review Panel affirmed and adopted (with a modification) in its report filed June 29, 1976. It is *concluded* and reported to the United States Senate (1) that claimant is equitably due a retroactive promotion to captain as of July 1, 1947 and retroactive retirement in that grade as of July 1, 1955; (2) that there is equitably due claimant $3,502.50 representing the difference between the active-duty pay of a captain and that of a commander for the period from July 1, 1947 through June 30, 1951; (3) that there is equitably due claimant $22,404.28 representing the difference between the active-duty pay and allowances of a captain and the retired pay of a commander for the period from July 1, 1951 through June 30, 1955, less reduction of $6,240 because of claimant's failure to make a reasonable effort to mitigate his damages during this 4-year period; (4) that there is equitably due claimant $56,379.37 representing the difference between the retired pay of a captain and that of a commander for the period from July 1, 1955 through December 31, 1975 (plus appropriate increments subsequent to December 31, 1975); (5) that claimant may not retroactively change his annuity election under the Retired Serviceman's Family Protection Plan statute; (6) that claimant is not legally or equitably entitled to attorney fees and expenses; and (7) that, after reducing the amounts awarded claimant because of additional contributions to the Family Protection Plan which he would have made as a captain, the total amount equitably due claimant as of December 31, 1975 is $75,160.55.

Congressional reference; military pay claim; active duty pay; non-promotion in naval service; "constructive" retirement date.

[1] Where it has been determined that claimant suffered non-promotion from commander to captain as a probable consequence of

improper and inequitable actions within the Navy Department, and where claimant could and would have served on active duty as a captain to June 30, 1955, rather than retiring on July 1, 1951, but for said actions, claimant is equitably entitled to be regarded as having served on active duty as a captain until June 30, 1955, and is entitled to the difference between the active-duty pay of a captain with his length of service and the retired pay of a commander which he has received, for the period July 1, 1951 to June 30, 1955, to basic allowances for quarters and subsistances for said period, and to the difference the retired pay of a captain with 31 years' active service and the retired pay of a commander with over 27 years' active service from and after July 1, 1955.

Congressional reference; military pay claim; active duty pay; recovery, measure of; interim earnings; duty to mitigate.

[2] All civilian employees and members of the Armed Forces who successfully assert legal claims based upon wrongful discharges or releases from the service by the Government are subject to having their awards of active-duty compensation reduced by the amounts they have earned, or which they could have earned with reasonable efforts, during the period of constructive active duty. This obligation applies to claimants having either a legal claim or an equitable claim against the Government. Doing equity, in the broad sense, to the present claimant should not be accomplished in a manner that unfairly discriminates against legal claimants who have also been wrongfully discharged or released by the Government, such as by not requiring the present claimant to make a reasonable effort to mitigate. This obligation, however, does not apply to time that is reasonably consumed in attempting to secure redress for the injustice suffered.

Military pay; Retired Serviceman's Family Protection Plan, annuity election.

[3] Once made, an election of an annuity pursuant to the Uniformed Services Contingency Option Act (now the Retired Serviceman's Family Protection Plan), can be revoked only in specified, limited situations not present in this congressional reference case. It is essentially inconsistent with the congressional purpose and intent in enacting the Family Protection Plan statute to permit a retroactive change in the substantive terms of an election thereunder simply because of the benefit of hindsight, particularly where claimant's original election cannot properly and equitably be attributed to either his financial inability to afford greater coverage or to defendant's inequitable treatment of him.

Congressional reference; military pay claim; active duty pay; recovery, measure of; attorney fees and expenses.

[4] While S. 881 and S. Res. 96 are before the Chief Commissioner for a report "on the amount legally or equitably due from the United States to the claimant," whether the amount should include

attorney fees and expenses was not decided by the Review Panel in 1972, and is not governed by the language of S. 881. Were the present claim before the court under the Tucker Act, litigation expenses would not be recoverable pursuant to 28 U.S.C. § 2412; that the claim is here pursuant to Sec. 1492 does not require or permit a different conclusion, even though claimant has had a time-consuming and expensive battle in establishing his equitable rights. To award attorney fees and expenses to claimant would constitute preferential treatment to him, and cannot be recommended.

[The complete reports of Trial Commissioner Wood and of the Review Panel are not reprinted here.]

Myer Feldman, attorney of recored for plaintiff. *Philip L. Cohan* and *Ginsburg, Feldman and Bress*, of counsel.

Howard G. Slavit, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Lt. Col. Donald Smith*, of counsel.

ORDERS

No. 622–71. May 14, 1976

Consolidated Box Company, Inc.

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; bonuses paid to executives; character of business; efficiency; reasonableness of costs and profits; comparable industry.—On February 18, 1976 Trial Judge David Schwartz filed a recommended decision (reported in full text at 22 CCF para. 80093) in this proceeding under the Renegotiation Act of 1941, as amended, for a de novo redetermination, following an initial determination by the Renegotiation Board, of the excessive profits, if any, earned by plaintiff from its contracts and subcontracts subject to the Act. On May 14, 1976 the court entered the following order:

"Following the filing of an opinion, findings and conclusion of law by the trial judge, this case comes before the court on a stipulation of the parties filed April 27, 1976, signed on behalf of the plaintiff and the defendant, whereby the parties agreed that plaintiff had realized excessive profits in the amount of $830,000 from contracts and/or subcontracts subject to the Renegotiation Act of 1951 during its fiscal year ended December 31, 1967, said amount, with the Section 1481 tax credit and interest to be computed and paid to the appropriate agency of the United States Government.

"IT IS THEREFORE ORDERED AND DETERMINED that pursuant to the stipulation referred to above, plaintiff realized excessive profits in the amount of $830,000 from contracts and/or subcontracts subject to the Renegotiation Act of 1951 during its fiscal year ended December 31, 1967, said amount, with the Section 1481 tax credit and interest, to be computed and paid to the appropriate agency of the United States Government, and

"IT IS FURTHER ORDERED AND DETERMINED that plaintiff shall, in full settlement of its liability involved in this litigation, pay to defendant the tentative net amount owing of $431,600 plus interest at the rate of $44.0437 per day from April 1, 1976 to and including the date that payment is received by the Government; and in the event Section 1481 credit is determined to be less than $398,400, plaintiff shall in addition pay to defendant any such difference, plus interest at 4 percent per annum commencing October 28, 1970, to and including the date that payment is received by the Government."

No. 272–70. MAY 28, 1976

Baltimore Contractors, Inc.

Pleading and practice; discovery; production of documents; legislative privilege; in camera inspection.—On May 28, 1976 the court, *en banc*, entered the following order:

"This case comes before the court on the parties' requests for review of Trial Judge Louis Spector's interlocutory order of March 3, 1976 (passing upon plaintiff's motion for deposition upon oral examination, plaintiff's motion for sanctions, plaintiff's motion for trial de novo on all issues, and defendant's motion to require plaintiff to file motion for summary judgment) and on the suggestions of both parties that these requests for review be considered *en banc*. The Chief Judge has ordered under Rule 7(b) that the requests for review be considered and determined *en banc*, and they have been so considered.

"After consideration of the parties' presentations, but without oral argument, the court *en banc* affirms the Trial Judge's order in all particulars, generally for the reasons given by him, except with respect to the defendant's claim of legislative privilege relating to the minutes and files of the House Office Building Commission.

"On the latter issue the court deems it unnecessary, at this point of the case, to go beyond the suggestion set forth in footnote 15 (page 30) of the defendant's request for review, *i.e.* that if the court deems it appropriate the House Office Building Commission will voluntarily honor a request by

the court for access to the documents for the purpose of the court's *in camera* inspection, without any waiver of the claim of legislative privilege. The court deems such *in camera* inspection to be appropriate and therefore accepts the offer made by the House Building Commission, directing that the *in camera* inspection be initially made on behalf of the court by the trial judge. The trial judge will not make these documents (or any of them) or their contents available for the inspection of the plaintiff or its counsel. However, if the trial judge finds that the documents (or any of them) are relevant and material to plaintiff's case and that disclosure to plaintiff or its counsel is substantially necessary, he shall so advise the parties without disclosing the documents or their contents, or delivering them to plaintiff or its counsel. If he reaches a contrary result, he shall likewise so notify the parties. If either party is dissatisfied with the trial judge's ruling, one way or the other, such party shall have the right to review by the court of such ruling. At that time the House of Representatives will have the right to reassert its claim of legislative privilege if it desires to do so.

"IT IS THEREFORE ORDERED that the parties' requests for review of Trial Judge Spector's order of March 3, 1976 are both denied and such order is affirmed except that with respect to the minutes and files of the House Office Building Commission the procedure to be followed will be that set forth in the preceding paragraph of this order."

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Pursuant to the foregoing order, the trial judge made an *in camera* inspection of the material furnished for examination composed of two numbered parcels, Parcel I consisting of House Office Building Commission Minutes of Meetings, 1963—July 1976, and Parcel II, in two folders, consisting of office records pertaining to administration of the contract involved in the present action. As set forth in an interlocutory order filed December 8, 1976, the trial judge concluded that plaintiff should be afforded an opportunity to examine Parcel II composed essentially of papers already public documents and which do not have the characteristics of a file as to which privilege is ordinarily asserted. The

trial judge also concluded that plaintiff is entitled to have produced only those items of Parcel I specifically identified in his order.

No. 61–73. MAY 28, 1976

Sun Shipbuilding & Dry Dock Co.

Contracts; change orders; delays; substantial evidence.— Plaintiff entered into a tripartite agreement for construction of five single-screw cargo vessels and delivery to United States Lines Company (USL) on or before certain specified dates, the contract obligating USL to pay 51.4% and the United States (acting through the Maritime Subsidy Board) to pay, as a construction-differential subsidy, 48.6% of the construction costs. During construction of the first vessel Change Order 23 was issued providing for automation of the engine room in each ship, resulting in reduction of crew size needed for the vessels' operation, and Change Order 48 thereafter was issued changing the plans for the crew quarters. The vessels were constructed and delivered on dates which were beyond the respective delivery dates specified in the contract. Plaintiff appealed administratively for additional compensation because of the extra work occasioned by said change orders, and as a result of the Secretary of Commerce's review of the various appeal proceedings plaintiff was awarded additional compensation. Plaintiff in the present action sought judgment against the United States on the basis of an alleged breach of the contract by the Board (Count I), and review under Wunderlich Act standards of the Secretary's order (Count II) and an increase in the award. Count I was dismissed pursuant to the court's order dated May 31, 1974, 204 Ct. Cl. 917. On May 28, 1976 the court entered the following order:

Before DAVIS, *Judge*, Presiding, LARAMORE, *Senior Judge*, and KASHIWA, *Judge*.

"This case comes before the court on the three parties' (plaintiffs, defendant, third-party United States Lines) requests for review of the recommended decision of Trial Judge Mastin G. White, filed October 14, 1975 [reported in full at 21 CCF para. 84310], with respect to the parties'

cross-motions for summary judgment on Count II of the petition which is governed by the Wunderlich Act. Oral argument has been had and the briefs have been considered.

"The court agrees with the Trial Judge's opinion (copies of which have been furnished to the parties) and adopts that opinion as the basis for its judgment, except for the so-called "Hire-Fire Costs" issue.

"On that question the court does not agree with and does not accept the Trial Judge's opinion and conclusion, but determines instead that the final refusal of the Department of Commerce to grant 'hire-fire costs' was not arbitrary, capricious, or unsupported by substantial evidence. The Trial Judge relied mainly on the testimony of Sun's high officials to the effect that Sun had contemplated using the laid-off outfitting men on the first United States Lines vessel, that it was the delay in the launching of the first ship to be constructed under this contract which made it necessary for Sun to lay off these outfitting personnel in late December of 1963 and January and February of 1964, and that such delay was due to the disruption caused by the issuance of Change Orders 23 and 48. We conclude, on the other hand, that the Board and the Secretary of Commerce could permissibly find this conclusory and summary testimony outweighed by (1) the inability of Sun's Manager of Industrial Relations, who was supposed to support with detail the conclusions of the high officials, to tie the lay-offs specifically to Changes 23 and 48; (2) the fact that under its own original schedule Sun had anticipated a long delay (so long as to make it unlikely that it would have retained the workers in question) between the launching of the next previous vessel (the Atlantic Heritage) and the first of the five ships involved in the present contract; and (3) other simultaneous delay factors (including the interchange of the first two hulls), not attributable to Changes 23 and 48, for which Sun was itself responsible, and which would have made it improbable that the first United States Lines vessel would have been ready in time to receive the laid-off outfitting personnel from the Atlantic Heritage.

"This disposition makes it unnecessary under the court's *en banc* order of May 31, 1974 [204 Ct. Cl. 915], to consider

the arguments made by the United States Lines and the *amicus* as to the bearing on this case of *United States* v. *Rice*, 317 U.S. 61 (1942), and *United States* v. *Blair*, 321 U.S. 730 (1944), and the problem of so-called 'delay damages.' Since we affirm the administrative award without adding to it, there are no possible offsets available in this court to the United States Lines; therefore we need not reach (and we take no position on) those issues.

"IT IS THEREFORE ORDERED AND CONCLUDED that the determination of the Secretary of Commerce, insofar as properly challenged by the parties, was neither arbitrary, capricious, unsupported by substantial evidence, nor legally erroneous, and accordingly that the summary judgment motions of the defendant and the third party are granted, the plaintiff's motion is denied, and Count II of the petition is dismissed."

Plaintiff's petition for certiorari was denied November 29, 1976.

Nos. 253–73 and 419–73. MAY 28, 1976

Red Ball Motor Freight, Inc.

Carriers; rates, fares and charges; tariff schedules; empty projectiles.—On May 28, 1976 the court entered the following order:

Before DAVIS, *Judge*, Presiding, LARAMORE, *Senior Judge*, and SKELTON, *Judge*.

"These companion cases come before the court on cross-motions for summary judgment, having been submitted without oral argument. The question is whether plaintiff, a common carrier by truck, is entitled to the class rate for certain transportation services for the Government or whether the charges are properly governed by lower Section 22 tenders. The items (empty projectiles) were shipped from the Twin Cities Army Ammunition Plant in Minnesota by other common carriers and were interlined or interchanged with plaintiff at various locations. Plaintiff carried the shipments from the interline or interchange points to Doyline, La., the final destination. In No. 253–73, defendant first paid at the class rates (at which plaintiff billed) but then deducted (from

amounts due on other bills) the excess over the Section 22 rate. In No. 419–73 plaintiff billed at the Section 22 rate but later sought the higher class rates which defendant refused to pay. Plaintiff is admittedly governed by the Section 22 tenders, offered by the originating carriers, if those tenders apply to these shipments.

"The Section 22 tenders covered the shipment of empty projectiles (or rocket heads) from New Brighton, Minnesota, to Doyline, Louisiana (one tender listed the originating point as 'Minneapolis & St. Paul Minnesota & Commercial Zones'). The problem is created by the fact that the Twin Cities Army Ammunition Plant (the origin of all the shipments) lies only in lesser part within New Brighton, the main portion of the plant being outside but adjoining New Brighton. Construing these tenders narrowly and literally, plaintiff says that for this reason they do not cover the shipments.

"We think, however, that the tenders must be construed to include these shipments. At the relevant times the mailing address for the Twin Cities Army Ammunition Plant was New Brighton, it was partially located in New Brighton, and there was no other facility in that city which was a storage place for these projectiles or rocket heads or which could have been a point of origin for shipments of those items. The originating carriers which filed the tenders clearly intended them to apply on shipments from the Twin Cities Army Ammunition Plant, and the bills of lading recited the tenders as the rate authority. If plaintiff were right, the tenders would have no application to any shipment at all.

"The controlling principles are that for Section 22 quotations, like other freight tariffs, the intent of the parties is controlling (*Union Pacific R.R.* v. *United States*, 193 Ct. Cl. 521, 529, 434 F. 2d 1341, 1345 (1970)), that a reasonable construction linked to the shipped article is to be preferred over an absurd, strained, unnatural or improbable reading (*Trans Ocean Van Service* v. *United States*, 192 Ct. Cl. 75, 91, 426 F. 2d 329, 336 (1970); *Southern Pacific Trans. Co. v. United States*, 197 Ct. Cl. 143, 151, 454 F. 2d 740, 745 (1972)), and that Section 22 ambiguities are resolved against the carrier (*Hughes Trans. Co.* v. *United States*, 169 Ct. Cl. 63, 68

(1965)). Under those principles, the quotations involved here must be interpreted as covering the disputed shipments.*

"IT IS THEREFORE ORDERED that plaintiff's motion for summary judgment is denied in both cases, the defendant's cross-motion is granted, the petitions are dismissed and judgment is entered in favor of the defendant on its counterclaim in No. 253–73 in the amount of $6.30."

No. 334–73. May 28, 1976

Cen-Vi-Ro of Texas, Inc., et al.

Contracts; interpretation; ambiguity noted during performance; contemporaneous interpretation; failure to protest Government's interpretation of specifications, effect of during production difficulties; scope of review by Court of Claims of administrative decision; use of hearsay evidence before Contract Appeals Board; remand to Board to establish actual or reasonable costs.—Plaintiff seeks review under Wunderlich Act criteria of two decisions of the Interior Board of Contract Appeals (70–1 BCA para. 8297 and 73–1 BCA para. 9903) which allowed plaintiff $223,529.78 on a total claim of $3,297,385.05, in connection with plaintiff's contracts for concrete pipeline construction, pipe laying, etc. to furnish water to cities in the Texas Panhandle. On May 28, 1976 the court entered the following order:

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and KASHIWA, *Judge*.

"This case comes before the court on plaintiff's and defendant's request for review of the recommended decision of Trial Judge Kenneth R. Harkins, pursuant to Rule 166(c) [reported in full text at 21 CCF para. 84057]. After hearing oral argument and considering the briefs of the parties, the court agrees, except as indicated below, with the trial judge's recommended decision, copies of which have already been furnished to the parties. Accordingly, the court hereby affirms

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*There is no doubt that the Twin Cities Ammunition Plant was within the "commercial zones" of Minneapolis and St. Paul and therefore that the one Section 22 quotation referring to that originating point applied to the shipment made under it.

and adopts the same, as modified, as the basis for its judgment in this case, with a slight change in the order of remand.

"IT IS THEREFORE ORDERED that plaintiff's motion for summary judgment is allowed in part and denied in part. Defendant's cross-motion is allowed in part and denied in part; and the case is remanded to the Interior Board of Contract Appeals, pursuant to Pub. L. No. 92–415 and Rules 149 and 150, for reconsideration of the equitable adjustment as appropriate in accordance with this decision. On remand, if plaintiff shows that its books and records were not kept in a manner which will enable it to establish its actual costs in support of an equitable adjustment, the IBCA shall permit plaintiff to support its claim for an equitable adjustment by other evidence, exclusive of the total cost method, which shows its reasonable costs. See *Bruce Constr. Corp.* v. *United States*, 163 Ct. Cl. 97, 324 F. 2d 516 (1963), and *Nager Elec. Co.* v. *United States*, 194 Ct. Cl. 835, 442 F. 2d 936 (1971)."

No. 440–73. MAY 28, 1976

Methonics, Incorporated

Contracts; default; waiver of delivery schedule; contractor's obligation re performance; reprocurement costs.— Plaintiff seeks review under Wunderlich Act standards of the decision of the Armed Services Board of Contract Appeals (73–1 BCA para. 9973), holding proper the termination for default of plaintiff's contract for failure to deliver incendiary liners, the contract items, in accordance with the contract's delivery schedule. Plaintiff also challenges the Board's determination that it is liable to defendant for failure to replace certain incendiary liners delivered to defendant for which it had been paid but which were thereafter returned to plaintiff as defective. On May 28, 1976 the court entered the following order:

Before DAVIS, *Judge*, Presiding, LARAMORE, *Senior Judge*, and SKELTON, *Judge*.

"This case comes before the court on plaintiff's request for review of the recommended decision of Trial Judge Thomas J. Lydon, filed August 25, 1975 [reported in full text at 21 CCF para. 84198], on the parties' cross-motions for summary

judgment in this Wunderlich Act case. Oral argument has been had and the briefs have been considered.

"The court agrees with the Trial Judge's conclusion and with most of his opinion (copies of which have been furnished to the parties) but finds it unnecessary to pass on certain of the issues considered by him in his opinion. For the court the critical point is that, even assuming that plaintiff may not have been able to anticipate the presence of lead in the misch metal, it still did not do what it could and should have done to forward performance during the period from early September 1971 (when the existence of lead was first ascertained) until the default termination. See particularly the Trial Judge's discussion in Part III of his opinion under the heading 'Waiver of the Delivery Schedule.' Lead is an impurity and plaintiff assumed the obligation to provide liners of misch metal with a specified maximum percentage of impurities. This obligation required it to do what it could, after the presence of lead was discovered, to bring down the lead percentage within acceptable limits. If there was a 'no lead at all' directive in September, plaintiff had no reason to consider that it was permanent or anything but a temporary expedient. AMMET, plaintiff's supplier, was able, by the end of September, to control the lead content of its material to under 0.5 percent (within the limit set by the specifications), but plaintiff had by then disabled itself from performing and made no real effort to do so. Consequently, it could not itself manufacture misch metal liners with impurities of no more than 0.5 percent, and sought to subcontract to another producer (at the expense of that other producer's own obligations). On this view it is unnecessary to consider whether plaintiff should or should not have anticipated the presence of lead in the misch metal, and accordingly the court, by-passing the issue, does not adopt pp. 43–53 (first half) of the Trial Judge's opinion.

"To clarify the issue which remains for decision by the ASBCA the court points out that under the Government's claim (*see* Part IV of the Trial Judge's opinion) the defendant is entitled to a refund of the money paid to plaintiff for the 16,550 defective liners never replaced and also to the excess reprocurement costs, if any, incurred by the defendant

in replacing those particular liners. No other reprocurement costs are involved or are to be awarded.

"IT IS THEREFORE CONCLUDED AND ORDERED that defendant's cross-motion for summary judgment is granted and plaintiff's motion for summary judgment is denied. Further proceedings are stayed pursuant to Rule 149 for a period of 3 months to afford the parties an opportunity to obtain an administrative determination of the amount of plaintiff's liability to defendant, a matter that was suspended in ASBCA No. 18708 pending the decision herein and which should now be immediately reinstated. The attorney of record for defendant is assigned the responsibility to advise the court, by letter to the Trial Judge (with copy to opposing counsel) of the status of proceedings on remand, such advice to be given initially 3 months, or less if the matter is resolved or determined, from the date hereof, and every 60 days thereafter. The attention of counsel and the Board is also directed to Rule 150."

Plaintiff's motion for rehearing was denied June 25, 1976.

No. 31–74. MAY 28, 1976

Ronald C. Bodine

Taking; Government use of airspace; interference with sky-diving business.—On May 28, 1976 the court entered the following order:

Before SKELTON, *Judge*, Presiding, KASHIWA and BENNETT, *Judges*.

"This case comes before the court on a stipulation of facts and defendant's request to dismiss plaintiff's petition.

"The case involves a claim by the plaintiff, Ronald C. Bodine, that the United States is interfering with his use of airspace over land he is leasing. The area concerned is near Lemoore Naval Air Station in southern California. In 1961, the United States Navy began flying operations at Lemoore. The airfield serves primarily as a training facility for pilots in the Navy. The field also serves the usual transient military flights. During the years 1972–74, the period involved in this suit, Lemoore was the home base for approximately

380 military jet aircraft. The field is thus one of the biggest and busiest of jet airfields operated by the United States. In the spring of 1972, the plaintiff began preparations for a sky-diving or sport parachute center from an abandoned airstrip on a piece of property some 12½ miles northeast of Lemoore. Plaintiff proposed to fly sky-jumpers to various altitudes up to 12,500 feet above the property from which they would descend, by free-fall and parachute, hopefully to land on the property being leased by the plaintiff. To conduct his sky-diving business, plaintiff was required to obtain permission or approval from the Federal Aviation Administration, the Fresno County Board of Supervisors, and the California Aeronautics Board. Plaintiff filed applications with all three agencies in May and June of 1972. The Navy immediately protested that the sky-diving would conflict with operations at Lemoore. In various actions in the agencies extending over an 18-month period, the applications were approved over the strong objections of the Navy. Ultimately, however, the County of Fresno voided plaintiff's permit for 'failure to submit a Site Plan Review Application' and 'failure to initiate any site development within one year.' The county invited plaintiff to reapply, but plaintiff filed this suit instead, contending that the Navy's continuing use of the airspace above his property constitutes the taking of an interest in his property in the character of a navigation easement, for which the payment of just compensation is required.

"We hold that plaintiff's claim must fail for the following reasons. First of all, plaintiff seeks to charge the defendant with imposing an easement not on the land, but on the airspace itself. While *United States* v. *Causby*, 328 U.S. 256 (1946) holds the Government liable for destroying a plaintiff's use of *land* by means of the noise and disturbance of aircraft, there are no cases concerning the wrongful use of airspace only. Since there is no adverse effect on the land, plaintiff has not suffered a compensable taking.

"Secondly, the airspace over the United States is a public highway, open to use by everyone and controlled by the Government. *United States* v. *Causby*, *supra* at 261. To recognize private claims such as the one plaintiff advances in

this case would clog these air highways, seriously interfere with their control and development, and transfer into private ownership airspace to which only the public has a just claim. If such private ownership were to prevail, every transcontinental flight would subject the operator to countless trespass suits. 'Common sense revolts at the idea.' *United States* v. *Causby*, *supra* at 261.

"Third, the 'taking' alleged by the plaintiff, *i.e.*, an inability to conduct a sky-diving business, was the result of actions by Fresno County and not by the United States. For the United States to be liable under the fifth amendment for a 'taking' of property, the United States must have done something which has resulted in a loss of property rights held by the plaintiff. Cases in this court have expressed a requirement that before there is a taking of property there must be either an express or implied intention by the United States for such taking. *Biggs Rental Co.* v. *United States*, 173 Ct. Cl. 789, 353 F. 2d 1013 (1965), *cert. denied*, 384 U.S. 927 (1966). Under the facts of this case, the United States has not 'taken' any property right owned or claimed by plaintiff. Plaintiff has been frustrated in his business venture by actions of Fresno County. These actions were taken, at least in part, because of information supplied by the Navy. The Navy can be said to be vigilant, aggressive, and perhaps more, but it cannot be said that supplying information on an assertedly hazardous situation constitutes a 'taking' of property within the fifth amendment.

"Based upon the Stipulation for Determination of Issue of Liability filed by the parties on November 14, 1975, the court determines that the defendant has no liability to the plaintiff and therefore the plaintiff's petition is dismissed."

No. 207–74. MAY 28, 1976

Thomas C. Nibali

Civilian pay; dismissal; sufficiency of evidence; remand to trial division.—On May 28, 1976 the court entered the following order:

Before COWEN, *Chief Judge*, and DAVIS and KUNZIG, *Judges*.

"This case comes before the court on cross-motions for summary judgment. Oral argument has been had and the briefs have been considered. Plaintiff, an Internal Revenue Service supervisory employee, sues for back pay on the ground that his removal from his position was illegal and improper. He was charged with having, and found to have, (1) solicited a $15,000 bribe from two taxpayers, (2) accepted a bribe in that amount from the same taxpayers, and (3) made false statements in connection with an audit examination involving those taxpayers.

"After careful consideration the court is of the view that this is one of those personnel cases in this court which merit a trial here of the facts, even though an administrative proceeding and hearing have been had. As we now see it, the case turns on the adequacy of the evidence to support the first two charges—solicitation and receipt of a bribe. (If those two charges fail, the removal cannot be sustained on the third reason alone.) Before the administrative proceedings now in question, those two primary issues were tried out in two criminal trials in which the present plaintiff was the defendant. At the first trial he was acquitted of accepting the bribe and the jury disagreed as to the charge of solicitation; at the second trial, at which the charge of accepting a bribe was of course dropped, he was acquitted of solicitation (as well as of making false statements in the audit). The two persons alleged to have paid the bribe (Mr. Ruff and Mrs. Dokas) both testified at the criminal trials but did not personally appear at the subsequent administrative hearing; instead, only their testimony at the first trial was produced in transcript form at the Civil Service Commission hearing. There was conflicting evidence at the latter hearing—including plaintiff's flat denial of the charges—and the two bribe charges cannot be sustained without accepting the testimony of Mr. Ruff and Mrs. Dokas. But no decider in the administrative proceedings had the benefit of observing Mr. Ruff and Mrs. Dokas (the crucial accusing witnesses) on the stand and, moreover, those administrative deciders had the benefit only of their testimony at one of the two criminal trials. The two juries which heard their testimony were either unconvinced or, at best, harbored substantial doubt. On the bare

written record we now have before us the court is uncertain whether the administrative finders had adequate support for their determinations. That question depends on the credibility of the conflicting testimony which, in turn, could well be markedly influenced by demeanor and personal observation. Moreover, the sanction involved here is a heavy one—removal on a stigmatizing charge involving bribery, after about twenty-three years of IRS employment.

"In these circumstances we consider it necessary that the trier of fact in the removal proceeding observe, compare, and evaluate the testimony of Mr. Ruff, Mrs. Dokas and plaintiff. That was not and could not be done at the administrative hearing (since Mr. Ruff and Mrs. Dokas did not appear there) but it can appropriately be done in the trial division of this court which possesses the subpoena power over non-federal personnel lacking in the Civil Service Commission.

"Accordingly, without foreclosing the plaintiff or defendant from again raising any issues (aside from the substantiality of the evidence in the present administrative record) which may survive a trial in this court,

"IT IS ORDERED that the cross-motions for summary judgment are both denied and the case is remanded to the Trial Division for further proceedings to ascertain the facts."

On September 30, 1976 the court denied defendant's suggestion for rehearing *en banc* (Judge Bennett would allow defendant's suggestion), and also denied defendant's motion for rehearing.

No. 33-75. MAY 28, 1976

Louis Schovanec

Military pay; active duty status; entitlement to benefits for injury sustained on active duty status; Military Airlift Command; associate Air Force reservist.—On May 28, 1976 the court entered the following order:

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and KASHIWA, *Judge*.

"This case comes before the court on defendant's and plaintiff's respective motions for summary judgment. The controversy concerns the decision of the Air Force Board for

the Correction of Military Records that plaintiff, an Air Force Reservist pilot participating in the service's Reserve Associate Unit Program under the Military Airlift Command (MAC), was not on active duty at the time he sustained injury in an automobile accident and consequently was not entitled to those benefits accruing to members of the Armed Services injured while on active duty status.

"Plaintiff contends that the Board's decision was erroneous because Paragraph 22.6 of Military Airlift Command Regulation MM 55–1 continues an aircraft crew member on active duty status for up to three days following the termination of a flight mission. Plaintiff returned from a flight mission on December 21, 1970 and was voluntarily released from active duty status on that date. On December 23, 1970 plaintiff sustained serious injuries in an automobile accident.

"Oral argument was heard on plaintiff's contention that Paragraph 22.6 of MAC Regulation MM 55–1 required his continuation on active duty status at least through the time of his automobile accident and that the Board erred in not applying the regulation in plaintiff's favor. At oral argument defendant for the first time relied upon Appendix O to MAC Regulation MM 55–1 and with leave of the court added that document to the record. Appendix O specifies that Paragraph 22.6 of MAC Regulation MM 55–1 is not applicable to Air Force Reservists.

"On review of the various arguments presented by the parties it is concluded that plaintiff, regardless of his participation in the Reserve Associate Unit Program, was still an Air Force Reservist (10 U.S.C. § 8076 (1970)), and that as such Appendix O of MAC Regulation MM 55–1 excludes applicability of Paragraph 22.6 of that regulation to plaintiff. Plaintiff's contention that Appendix O exceptions to MAC Regulation MM 55–1 do not apply to plaintiff because an Air Force Program Directive excused Associate Reservists from its exceptions otherwise applicable to ordinary Air Force Reservists is misplaced. By its own terms the Program Action Directive excuses Associate Reservists only from those Appendix O exceptions dealing with aircrew standards of qualification and currency. The Program Action Directive did not void for Associate Reservists the Appendix O excep-

tions dealing with free time under MAC Regulation MM 55–1. Not only is the Program Action Directive specific that it did not excuse Associate Reservists from the Appendix O exceptions to the free time provisions of Paragraph 22.6 of MAC Regulation MM 55–1 but defendant has submitted an affidavit from the Air Force Officer in charge of preparing the Program Action Directive categorically denying that the Directive excused Associate Reservists from the applicability of Appendix O to Paragraph 22.6 of MAC Regulation MM 55–1.

"Therefore, IT IS ORDERED that defendant's motion for summary judgment be granted and that plaintiff's petition be dismissed."

On September 30, 1976 the court denied plaintiff's motion for reconsideration.

Nos. 151–75, 159–75, 453–75, 65–76, 113–76, 142–76 and 161–76. MAY 28, 1976

Louis G. Ruderer

Civilian pay.—On May 28, 1976 the court entered the following order:

L. G. Ruderer, *pro se.*

Stephen G. Anderson, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG AND BENNETT, *Judges.*

"The above cases are consolidated for the purpose of being dealt with in this order.

"The plaintiff, L. G. Ruderer, has for some time pursued a course of filing frivolous petitions in this court, thus wasting time which is needed for consideration and disposition of seriously intended petitions, filed by persons who honestly believe they have a cause of action, and often do. So far as we can tell from reading the Ruderer petitions, they are written without reference to any fact or law that might seriously be argued to authorize this court to grant relief.

They seem to have had their origin in the failure in the perhaps seriously intended petition in Ct. Cl. No. 85–67, dismissed as reported in *Ruderer* v. *United States*, 188 Ct. Cl. 456, 412 F. 2d 1285 (1969), *cert. denied* 398 U.S. 914 (1970). The flood of new cases since then purport on their faces to seek the undoing of that decision in some fanciful manner, but after careful consideration we cannot but conclude, as defendant says, the real object is harassment. That object is quite successfully achieved when we follow our normal procedures, which are intended to and do guarantee careful consideration for every petition.

"By order dated January 23, 1976 [208 Ct. Cl. 1019], we dismissed Mr. Ruderer's petitions, Ct. Cl. Nos. 103–75, 122–75, 137–75, 151–75 and 159–75. We denied all motions by plaintiff then pending and directed defendant not to respond to any paper filed by him in those cases thereafter, unless specifically ordered to do so by the court. The case numbers enumerated in the caption represent the subsequent accumulation of Ruderer petitions. In two of them, Nos. 453–75 and 142–76, we have motions by defendant and presumably, unless we act *sua sponte*, we will have motions to adjudicate in all of them, thus fully effectuating the purpose of harassment. It is obviously necessary to make a more drastic departure from our normal procedures, and this the court has now decided to do.

"Upon consideration of the foregoing, and without oral argument, IT IS ORDERED THAT

1. The petitions in the above numbered cases are dismissed with prejudice as frivolous.
2. All motions by plaintiff in the above numbered or any other cases in this court, up to the date of this order, are denied.
3. All motions by defendant in the above numbered cases are denied as moot in view of this order.
4. Defendant is directed to make henceforward no response to any paper filed by Mr. Ruderer, under any docket number or caption, the above or any other, unless it is specifically ordered to do so by the court. Defendant is assured it will not be defaulted in any such case. If we desire defendant to answer or make any dispositive motion, we will so advise it, otherwise the prescribed times for any such answers or motions are to be deemed indefinitely suspended."

Plaintiff's motions to set aside the foregoing judgment were denied June 25, 1976.

No. 598–71. JUNE 11, 1976

Mancon Liquidating Corp.

Renegotiation of contracts; pleading and practice; pretrial order, noncompliance with; involuntary dismissal, when appropriate; discovery availability.—On June 11, 1976 the the court entered the following order:

Dean Carlton, attorney of record for plaintiff.

Paul T. Michael with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges*.

"In this contracts renegotiation case plaintiff, Mancon Liquidating Corp., comes before the court seeking a *de novo* determination of excessive profits found by the Renegotiation Board for the fiscal year ending July 31, 1967. On September 12, 1975, the trial judge issued a standard Pre-trial Order on Accounting pursuant to Ct. Cl. Rule 111(d). Plaintiff's submission was filed on January 20, 1976, and contained several "blanks."

"Relying on Ct. Cl. Rules 102(b)(2) and 114(b)(5)[1] defendant now enters a motion to dismiss the action based upon plaintiff's non-compliance with the Pre-trial Order. Plaintiff acknowledges incomplete compliance, but claims it cannot

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[1] Ct. Cl. Rule 102 provides in part:

For failure of the plaintiff * * * to comply with these rules or with any other order of the court, the defendant may move that the court dismiss the action. [Ct. Cl. Rule 102(b)(2).]

Rule 114 specifies:

Upon the failure or refusal of a party to comply with any order or direction of the [trial judge] pursuant to the rules relating to pretrial procedure * * * the [trial judge] may—

* * * * *

(5) Recommend the dismissal of the action or proceeding * * *. [Ct. Cl. Rule 114(b)(5).]

satisfy all requirements since the desired records are now in the hands of an uncooperative third party.[2] Defendant also requests a stay of its obligations under the Pre-trial Order pending resolution of its dismissal motion.

"Upon consideration of defendant's motion and the parties' briefs, we deny defendant's motion to dismiss, but grant a stay of defendant's obligations.

"Initially, plaintiff's submissions throughout this proceeding attest to the fact that the records are unavailable. Defendant has acknowledged that plaintiff's records are in the custody of another company. Given these unique facts and plaintiff's expression of willingness to comply with future court orders to the best of its ability, plaintiff has "sufficient excuse" for incomplete production at this stage of the case.

"In addition, dismissal is a drastic action to be used only when clearly authorized, as in a case of wilful non-compliance with an order. *See, e.g., Societe Internationale* v. *Brownell*, 357 U.S. 197 (1958); *Bon Air Hotel, Inc.* v. *Time, Inc.*, 376 F. 2d 118 (5th Cir. 1967); *Fisher* v. *U.S. Fidelity & Guaranty Co.*, 246 F. 2d 344 (7th Cir. 1957). In the instant case dismissal is authorized under Rules 102(b)(2) and 114(b)(5). However, it does not appear that plaintiff's failure to totally comply with the Pretrial Order was wilful. Since less extreme sanctions for plaintiff's partial compliance are available in Rule 114(b), it does not appear that dismissal is appropriate at this time.

"Finally, defendant has available a range of alternatives to obtain the desired information. Defendant may subpoena the third party for an oral or written deposition and obtain a subpoena duces tecum for the documents. Ct. Cl. Rule 82. It may subpoena the third party as a witness at trial, along with the desired records. Ct. Cl. Rule 123. Finally, should the data be totally unavailable, defendant may enter a motion for summary judgment at the close of plaintiff's trial presentation under Ct. Cl. Rule 102(c). Given these alternative methods open to defendant, the dismissal of the case for

[2] Plaintiff says the required data is now in the hands of Intercontinental Mfg. Co. at Garland, Texas. Plaintiff sold its assets to Intercontinental in 1968, including the records. Plaintiff avers that Intercontinental has repeatedly refused access to the documents.

plaintiff's partial compliance with the Pre-trial Order is not warranted.

"In short, the acknowledged impossibility of plaintiff's total compliance with the Pre-trial Order, its willingness to assist in future discovery, the availability of less severe sanctions, and the alternative avenues of discovery open to defendant, all lead to the conclusion that defendant's motion to dismiss cannot be granted at this stage of the case. However, due to the time consumed in our resolution of defendant's motion to dismiss, we grant defendant a stay of its obligations under the Pre-trial Order.

"Accordingly, IT IS HEREBY ORDERED that defendant's motion to dismiss is denied and defendant's motion for a stay of its obligations under the Pre-trial Order is granted. Defendant's obligations under the Pre-trial Order must be met within ninety days of the date of this order."

No. 334–72. JUNE 11, 1976

Impresos Nacionales, S.A.

Contracts; forfeiture of fraudulent claims.—On June 11, 1976 the court entered the following order:

Frank J. Martin, Jr., attorney of record, for plaintiff. *Michael J. Shea, Jay L. Lazar* and *Sutherland, Asbill & Brennan*, of counsel.

Peter A. T. Sartin, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges*.

"This case comes before the court on plaintiff's motion, filed January 23, 1976, for summary judgment, having been considered, together with the response in opposition thereto, without oral argument.

"This is a suit for breach of contract in which the plaintiff has moved for summary judgment and the defendant insists that a trial is needed. Plaintiff is a Mexican printing firm

which was awarded in 1966 a contract for printing and distribution services, in Mexico, by a Mexican branch of the U.S. Agency for International Development (AID). After the "tooling up" period (during which plaintiff claims it expended substantial sums), but before any actual contract work had been placed by the Government, the contract was cancelled by AID. This suit for breach was brought some years later. The Government has interposed a number of defenses which, in its view, call for trial of the facts. The plaintiff's position is that, on the admitted facts, it is entitled to judgment.

"The central issue in the case is whether plaintiff's contract was the result of a fraudulent scheme to rig the bids and to pay kickbacks to a government official. The defendant has presented enough material to warrant a trial on that issue. If such fraud is shown, 28 U.S.C. § 2514 will be applicable; that statute is a condition of plaintiff's filing suit in this court and applies to every claim asserted by a plaintiff in this court. The other issues in the case should also be tried along with the main question of fraud.

"IT IS THEREFORE ORDERED that plaintiffs said motion for summary judgment be and the same is denied and the case is returned to the trial division for further appropriate action in view of this order."

No. 41-72. JUNE 11, 1976

Impresos Nacionales, S.A.

Contracts; forfeiture of fraudulent claims.—On June 11, 1976 the court entered the following order:

Frank J. Martin, Jr., attorney of record, for plaintiff. *Michael J. Shea*, *Jay L. Lazar* and *Sutherland, Asbill & Brennan*, of counsel.

Peter A. T. Sartin, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, *Judge, Presiding*, NICHOLS and KUNZIG, *Judges.*

"This case comes before the court on plaintiff's motion, filed February 19, 1976, for summary judgment, having been considered, together with the response in opposition thereto, without oral argument.

"The case is a companion to *Impresos Nacionales, S.A.* v. *United States*, *ante* at 697, and likewise involves contracts (made in Mexico) between the plaintiff, a Mexican printing firm, and a local branch of the U.S. Agency for International Development (AID), as to which the defendant alleges fraud on the part of plaintiff. This case is controlled by our order of this date in *Impresos Nacionales, S.A.* v. *United States*, *ante* at 697. Insofar as they became applicable, the claim-forfeiture statute, 28 U.S.C. § 2514 and the False Claims Act, 31 U.S.C. §§ 231–235, will be pertinent because, by suing in this court, plaintiff will have made them relevant to this case. The issues other than fraud should be tried along with that question.

"IT IS THEREFORE ORDERED that plaintiff's said motion for summary judgment be and the same is denied and the case is returned to the trial division for further appropriate action in view of this order."

No. 348–72. JUNE 11, 1976

The People of the State of California, Acting by and through the Department of Public Works

Contracts; interpretation; ambiguity; Federal v. State rights and liabilities; liability for relocation costs of Federally-owned water main.—The Department of the Interior, Bureau of Reclamation, pursuant to the Federal Reclamation laws, by contract dated March 7, 1956, with the Ventura River Municipal Water District (now Casitas Municipal Water District) constructed the Ventura River project. The water district is obligated to repay to the United States the costs related to construction of the system and is responsible for maintenance and operation thereof. Title to project works constructed by the United States remains in the latter, notwithstanding transfer of the works to the water district for operation and maintenance. As part of the project, the Bureau has constructed, and has retained title to,

35 miles of pipeline, to which the district subsequently has constructed, and has title to, approximately 60 additional miles. In 1958 the Bureau applied for and obtained from the State of California an encroachment permit to invade the right-of-way of State Highway 150 to construct a water main (the Ojai Valley main); work on the main was completed in April 1959. This case concerns the portion of the main located within and longitudinal to the right-of-way of Highway 150 at Thacher Creek. Title to the main is in the United States; it is maintained and operated by the Casitas Municipal Water District. In 1963 the State Division of Highways and the Bureau negotiated an agreement providing for the joint use of their respective rights-of-way where their respective facilities cross; this agreement incorporated by reference the 1958 encroachment permit. In 1971 the State Division of Highways was judicially ordered to replace the existing highway culvert spanning Thacher Creek at its juncture with Highway 150 by construction of a single span bridge, which required a section of the Ojai Valley main to be relocated. However, absent a procedure satisfactory to all parties permitting subsequent determination of liability for the cost of relocating the section of the main at Thacher Creek, the State constructed a temporary bridge that has not interfered with operation of the main; construction of a permanent bridge will follow determination of the liability issues in this case. Determination of responsibility for the cost of relocating the main to accommodate the bridge construction depends upon the effect of the 1963 agreement on the 1958 encroachment permit. Defendant asserts that the parties intended that the 1963 agreement supersede the 1958 permit; plaintiff contends that, by its terms, the 1963 agreement only applies to past crossings and future transverse crossings and has no application to portions of the main where invasion of the State's right-of-way is longitudinal and not a crossing. In a recommended decision filed February 19, 1976, Trial Judge Kenneth R. Harkins concluded that the 1963 agreement is ambiguous; that it did not supersede the provisions of the 1958 permit; that the terms of the 1958 permit expressly obligated the Bureau to bear the costs of relocating a segment of the main

to accommodate the State's bridge construction; and that as of filing of the recommended decision it has not been determined whether the Bureau or the water district ultimately will bear the relocation costs if the Bureau is found to be contractually liable. On June 11, 1976 the court sitting as a panel (Davis, *Judge*, Presiding, Nichols and Kunzig, *Judges*), entered an order granting plaintiff's motion to adopt the recommended decision, defendant having filed no intention to except thereto, adopted the said decision as the basis for its judgment in this case, concluded that plaintiff is entitled to recover, and entered judgment for plaintiff accordingly, the amount of recovery to be determined pursuant to Rule 131(c).

No. 456–73. JUNE 11, 1976

Donald C. Goewey

Pleading and practice; attorneys; dual role of advocate and witness.—On June 11, 1976 the court entered the following order:

Herbert P. Suskind, attorney of record, for plaintiff.

Kenneth J. Ingram, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges*.

"This case comes before the court on defendant's request, filed April 9, 1976, for review by the court, pursuant to Rule 53(c)(2)(i), of the trial judge's order of March 17, 1976, allowing plaintiff's counsel to testify as a fact witness at the trial of this case without first disqualifying himself as plaintiff's counsel in this litigation. Upon consideration thereof, together with the response in opposition thereto, without oral argument, it is concluded that the trial judge's said order should be and it is affirmed. See *Kenosha Auto Transport Corp.* v. *United States*, 206 Ct. Cl. 888 (1975).

"IT IS THEREFORE ORDERED that defendant's said request for review, filed April 9, 1976, be and the same is denied."

No. 276–74. JUNE 11, 1976

Central States Health & Life Company of Omaha

Setoff.—On June 11, 1976 the court entered the following order:

Francis M. Gregory, Jr., attorney of record, for plaintiff. *James V. Heffernan, David M. Flynn, Sutherland, Asbill & Brennan, Robert C. Fisk*, and *Finlayson, McKie & Fisk*, of counsel.

Bruce W. Reynolds, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges*.

"This case comes before the court on plaintiff's motion, filed March 19, 1976, for voluntary dismissal of remaining issues and on defendant's opposition thereto and motion for leave to amend answer, filed March 29, 1976, having been considered without oral argument.

"Plaintiff, Central States Health & Life Insurance Company of Omaha, is a mutual life insurance company as defined in Sec. 801(a) of the Internal Revenue Code (IRC). On August 2, 1974, plaintiff filed a petition in this court seeking a refund of income tax allegedly overpaid in 1965, 1966 and 1969, with interest, in the amount of $302,150.28.

"The court, by order of October 30, 1975 [207 Ct. Cl. 1047], granted plaintiff's motion for partial summary judgment on the issue set forth in paragraphs 10–14 of Part VII of the petition and in paragraphs 24–26 of Part IX. Pursuant to the order plaintiff is entitled to recover an amount to be determined under Rule 131(c) representing the appropriate Sec. 809(d)(5) deduction of a percentage of the premiums received on the non participating guaranteed renewable accident and health insurance contracts which are issued or renewed for 5 years or more.

"Plaintiff is before the court now asking us to dismiss with prejudice the remaining issue in its petition pursuant to Court of Claims Rule 102(a)(2). The question therein is whether

the increases in the costs of collecting deferred and uncollected premiums should have been deducted under Sec. 809(d)(5) and correspondingly, whether any decreases in costs should reduce the Sec. 809(d)(5) deduction. The IRS did not allow plaintiff to deduct the increase. However, the IRS did include, as part of the premiums, as defined in Sec. 809(c)(1), the increase during the year in the deferred and uncollected premiums and it reduced premiums where there was a decrease in such items. Plaintiff did not contest the inclusion of the increases in the premiums but only asked that the increase in costs for collecting these premiums be allowed as a deduction.

"Defendant avers that it raised in its answer, as an offset, the contention that plaintiff improperly included amounts attributable to deferred and uncollected premiums in its life insurance reserves for tax purposes. It wants to use this to reduce the claims plaintiff got judgment on. Defendant does not want to withdraw this offset and would oppose granting plaintiff's motion if it means dismissing the offset. Defendant contends that the issue raised in its answer does not depend on plaintiff's claim, but has asked for leave to amend its answer to make it clear that this is a separate issue. Its original answer asserted this claim only if the court determined that any amounts should be deducted or excluded from deferred and uncollected premiums. Its proposed amendment cuts that link.

"The court concludes that defendant is seeking an offset, or setoff, and is not raising an affirmative or avoidance defense such as *res judicata*, collateral estoppel, accord and satisfaction, etc. and it is therefore to be treated as a setoff and not as an affirmative defense. Defendant's entitlement to a setoff will not be prejudiced if we dismiss the remainder of plaintiff's claim and defendant can assert its setoff against that part of plaintiff's petition on which we have already granted summary judgment. Since plaintiff is seeking a dismissal with prejudice, it cannot bring suit in the future on the claim so dismissed.

"IT IS THEREFORE ORDERED that plaintiff's said motion, filed March 19, 1976, to voluntarily dismiss the remaining issues of the claim, as set forth therein, with prejudice is granted.

"IT IS FURTHER ORDERED that defendant's motion, filed March 29, 1976, for leave to amend the answer is granted.

"The case is returned to the trial division for further appropriate proceedings."

No. 306–74. JUNE 11, 1976

Cecil Blaffer Hudson and Richard M. Sheridan

Pleading and practice; involuntary dismissal, when appropriate.—On June 11, 1976 the court entered the following order:

Charles W. Hall, attorney of record, for plaintiff. *Gerald W. Haddock*, of counsel.

Donald H. Olson, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

Before DAVIS, *Judge*, Presiding, NICHOLS AND KUNZIG, *Judges*.

"This case comes before the court on defendant's motion, filed February 4, 1976, to dismiss plaintiff's petition, having been considered, together with the response in opposition thereto, without oral argument. The single motion before us in this tax refund suit is the Government's motion to dismiss plaintiff's petition as a sanction for the material alteration of relevant evidence shortly before the scheduled trial date. The merits of the case, not before us at this time, focus on the fair market value of a certain painting in 1967 and 1968, in which years gifts of undivided interests in the paintings were made to the University of Houston and claimed as charitable deductions. It is this painting which was altered, allegedly with the authorization of plaintiffs, in December 1975 (a little over a month before the scheduled trial date in January 1976; and allegedly after the Government had indicated that it wished the painting itself to be available at the trial for inspection). The Government believes dismissal is appropriate because the alteration has prejudiced the Gov-

ernment's case on the 1967–68 value of the painting and constituted a flagrant usurpation of the trial judge's authority to determine evidentiary issues.

"We need not and do not examine our authority to dismiss under the circumstances presented by the Government because dismissal would be unjustified even if within our power. Dismissal is a severe sanction to be imposed only in extreme situations. *See, e.g., Micrecord Corp.* v. *United States*, 161 Ct. Cl. 763, 765 (1963); *Finley* v. *Parvin/Dohrmann Co.*, 520 F. 2d 386, 391 (2d Cir. 1975); *Marshall* v. *Sielaff*, 492 F. 2d 917, 918 (3d Cir. 1974); *Mann* v. *Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 488 F. 2d 75, 76 (5th Cir. 1973); *cf. Law* v. *United States*, 195 Ct. Cl. 370, 440–41 (1971) (forfeiture of a claim, under 28 U.S.C. § 2514, is a harsh penalty to be imposed only upon clear and convincing evidence of fraud). Plaintiffs did not disobey any court order, and the Government has not provided clear and convincing evidence that the plaintiffs knew before the painting was delivered for cleaning that the Government wanted to have the painting (in its overpainted condition) present at the trial. Until the Government's attorneys wrote a letter which plaintiffs' counsel quite possibly did not receive or read before the painting was cleaned, the Government had expressed only the desire to have photographs available at trial. Plaintiffs secured the requested photographs before the painting was cleaned and have given those pictures to the Government. Thus, the Government has not demonstrated that plaintiffs defied a known wish of the Government and has acknowledged plaintiffs' compliance with the one request of which they definitely were aware. Finally, because plaintiffs have the burden of proof, it is they, not the Government, who will suffer the consequences if the cleaning of the painting precludes ascertainment of the value of the painting in 1967 and 1968. For these reasons, dismissal would be unduly harsh. The Government remains free to persuade the trier of fact, if it can, that the plaintiff's actions indicate awareness of having a bad case. This is the most customary sanction for tampering with evidence when not in violation of law or order of the court.

"IT IS THEREFORE ORDERED that defendant's said motion, filed February 4, 1976, to dismiss the petition be and the same is

denied and the case is returned to the trial division for further appropriate proceedings."

No. 448–74. JUNE 11, 1976

Peter D. Bogart

Contracts; breach; Disaster Relief Act of 1970; Small Business Administration disaster loan; extent of restoration of property.—On June 11, 1976 the court entered the following order:

Peter D. Bogart, pro se.

Susan M. Linden, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges*.

"In this contracts action plaintiff, a resident of Los Angeles, seeks to recover damages and repair costs occasioned by defendant's breach of an alleged express agreement to extend funds fully to restore damaged property. Plaintiff claims that he is entitled to recover based on defendant's refusal to perform a contract executed by the Small Business Administration (SBA).

"Defendant now enters a motion for summary judgment contending that plaintiff cannot recover based on a breach of express contract. Plaintiff counters with a cross-motion for partial summary judgment arguing that he is entitled to recover on the issue of defendant's liability. Upon consideration of the parties' motions, briefs and attachments, we hold for defendant.

"On February 9, 1971, a retaining wall in plaintiff's back yard was destroyed in an earthquake. A portion of plaintiff's property began to slide downhill. Pursuant to the Disaster Relief Act of 1970, 84 Stat. 1744 and 15 U.S.C. § 636(b)(1) (1970), defendant advertised the availability of loans to assist in cleanup and repair. Plaintiff responded by applying for an SBA disaster loan. His application included two

estimates of repair costs, one for $3200 and a second for $2400. After an appraiser set plaintiff's earthquake damage at $2400, the SBA on July 25, 1972, authorized a loan to plaintiff in this amount. The SBA notified plaintiff of its decision on August 3, 1972. Plaintiff repaired the retaining wall and on May 1, 1973, defendant loaned plaintiff the $2400.

"Despite such efforts, the repair work was unsuccessful. The retaining wall failed again. Plaintiff attributes the second failure to defendant's breach of the alleged promise to provide enough funds fully to restore his property to its original condition. Plaintiff brings the instant action in an attempt to recover damages attributable to defendant's alleged contract breach.

"The sole basis for plaintiff's suit is his belief that defendant executed an express written agreement promising fully to restore the retaining wall to its predisaster condition. Plaintiff relies on the Disaster Relief Act, SBA statutes, regulations and *loan* documents in support of his breach of contract claim. However, plaintiff has been unable to establish that he and defendant entered into an express contract for full reimbursement of plaintiff's disaster costs.

"The aim of the legislative provisions is to provide loan funds to mitigate the effect of disasters. However, nothing in these statutes mandates a contractual obligation on the part of the Government fully to restore property to predisaster conditions. To the contrary, the SBA's loan decision is a matter of discretion. *Cf. Raitport* v. *Small Business Administration*, 380 F. Supp. 1059 (E.D. Pa. 1974).

"The disaster relief regulations equally do not compel reimbursement. 13 C.F.R. § 123.3 relied upon by plaintiff is merely a general statement of intent:

> The purpose of these loans is to restore a victim's home * * * as nearly as possible to predisaster condition[s]. [13 C.F.R. § 123.3(a)(1)(1976)].

Like the disaster relief statutes, the regulation does not contractually obligate defendant to pay for plaintiff's disaster losses.

"Finally, the loan documents do not evidence an express agreement fully to reimburse plaintiff. The application is

clearly labeled 'Application for Disaster Loan-Home.' The authorization contains the heading 'Unsecured Disaster Loan-Direct.' The August 3, 1972, notification to plaintiff begins with the phrase 'Your loan request has been approved * * *.' The May 1, 1973, agreement bears the legend 'Disaster Loan Agreement.' Nowhere in any of these documents does defendant obligate itself to do anything other than lend $2400 to plaintiff for repair of the retaining wall. Plaintiff's express contract claims based on the loan documents cannot be upheld.

"We note that on a motion for summary judgment all facts must be considered in a light most favorable to the non-moving party. *Housing Corporation* v. *United States*, 199 Ct. Cl. 705, 468 F. 2d 922 (1972). We have so considered the facts presented in the instant case in evaluating defendant's motion. However, general conclusions do not substitute for genuine issues of fact. *Gross* v. *United States*, 205 Ct. Cl. 605, 613, 505 F. 2d 1271, 1276 (1974). Faced with defendant's motion for summary judgment plaintiff must do more than merely allege the existence of an express contract to pay his repair costs. He has failed in this duty.

"Accordingly, for the reasons stated above, IT IS HEREBY ORDERED THAT defendant's motion for summary judgment is granted, plaintiff's cross-motion for partial summary judgment is denied, and the petition is dismissed."

No. 95–75. JUNE 11, 1976

Diz Livestock Co., et al.

"Lease and Suspension" agreement; breach; withdrawal of Taylor Grazing Act permits.—On June 11, 1976 the court entered the following order:

Frederick A. Smith, attorney of record for plaintiff.

Gerald S. Fish, with whom was *Assistant Attorney General Peter R. Taft*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges*.

"This contracts and Taylor Grazing Act compensation case comes before the court on defendant's motion for summary judgment and plaintiffs' motion for oral argument.

"Plaintiffs, owners of New Mexico land rights, seek: (1) damages in lieu of specific performance of certain 'lease and suspension' agreements, or for defendant's alleged breach of the agreements, and (2) additional compensation under 43 U.S.C. § 315q (1970) (granting compensation for Government withdrawal of Taylor Grazing Act permits). Because plaintiffs cannot recover under the 'lease and suspension' agreements or under the Taylor Grazing Act, we hold for defendant.

"Plaintiffs' lands lie within the White Sands Missile Range in New Mexico. In World War II, part of the land (including the site of the first atomic bomb test) was used by defendant for a bombing and gunnery range. By 1946, defendant began to convert the area into a guided missile test range. As part of this development in 1949–50 defendant *leased* part of plaintiffs' interests (private ownership and state land leases) in certain lands and *suspended* plaintiffs' federal grazing permits in what has been called 'lease and suspension' agreements. The agreements called for a 'year to year' Government tenancy *not to continue beyond June 30, 1970*. Section 10 of the agreements required restoration of plaintiffs' lands to their original condition upon termination of the agreements. However, defendant could make a cash payment in lieu of restoration.

"By 1970, defendant discovered it had a continued need for plaintiffs' lands. Instead of renegotiating the agreements, the Government filed declarations of taking of plaintiffs' private ownership and state lease-hold interests in the United States District Court for the District of New Mexico. Rather than attempting to condemn the land outright, defendant appropriated the lands 'for a term of years beginning July 1, 1970, and ending June 30, 1980.' In the New Mexico proceedings, plaintiffs attempted to *halt the condemnation* based on an alleged breach by defendant of the 'lease and suspension' agreements. In a memorandum opinion, the district court

judge granted defendant's motion to strike plaintiffs' defense of equitable estoppel:

> Any claims against the United States for breaches of the lease and suspension agreement[s], if any, cannot be raised in this [condemnation] proceeding.

"Having failed to block the condemnation action based on the Government's alleged breach of the 'lease and suspension' agreements and on defendant's failure to pay for elimination of grazing privileges, plaintiffs brought the instant action in an attempt to recover damages. Specifically, plaintiffs say they are entitled to compensation because defendant failed under section 10 to return the lands to them in their original condition upon the June 30, 1970, expiration of the 'lease and suspension' agreements. Plaintiffs would have us find either that the Government's conduct *breached* section 10 of the agreements, or that plaintiffs are entitled to damages in lieu of specific performance of section 10. Plaintiffs also argue that they are entitled to compensation under 43 U.S.C. § 315q, due to defendant's cancellation of Grazing Act privileges.

"Defendant now enters a motion for summary judgment contending that plaintiffs cannot recover either under the 'lease and suspension' agreements or for any elimination of Grazing Act privileges.[1] Plaintiffs counter that there are factual issues which must be resolved before the court can settle the contract and Grazing Act issues. Plaintiffs also submit a motion for oral argument.

"Upon consideration of the parties' pleadings, motions, briefs, and exhibits, we grant defendant's motion for summary judgment and deny plaintiffs' motion for oral argument.

(1) The Contract Claims:

"The crux of plaintiffs' 'lease and suspension' agreement claims is that defendant was inalterably obligated under section 10 to restore plaintiffs to their lands upon termination of the agreements. Defendant did not restore plaintiffs, but

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[1] Defendant also argues that plaintiffs' claims are barred under the doctrine of *res judicata*. Since we hold that plaintiffs cannot recover either under the agreements or the Taylor Act, we need not reach this question.

instead condemned additional property rights. Plaintiffs now seek damages either for breach of section 10 or in lieu of specific performance of the same section.

"It is quite apparent that defendant's failure to return plaintiffs' property constitutes a *technical breach* of section 10 of the 'lease and suspension' agreements. However, there is no appropriate remedy for such a technical breach because plaintiffs have suffered no damages. *See, e.g., Micrecord Corp.* v. *United States*, 176 Ct. Cl. 46, 361 F. 2d 1000 (1966). At the instant it was obligated to restore plaintiffs, defendant properly condemned an additional ten-year interest in plaintiffs' lands. We cannot say that plaintiffs have been harmed by the Government's failure to restore plaintiffs for the few seconds it would take to satisfy the 'lease and suspension' agreement provisions. To hold otherwise would compel defendant to make a useless gesture.[2]

"In short, while defendant is perhaps guilty of a technical breach of the 'lease and suspension' agreements, plaintiffs have suffered no compensable loss from this breach. Therefore, plaintiffs' contract claims cannot stand.

(2) Taylor Grazing Act Claims:

"Plaintiffs also claim they are entitled to additional compensation for defendant's cancellation of Taylor Act grazing privileges. On cancellation, 43 U.S.C. § 315q (originally enacted in 1942) authorizes payments '*as the head of the department* * * * using the lands *shall determine* to be fair and reasonable for the losses suffered.' Plaintiffs seek additional compensation under this provision.

"Entitlement to compensation under section 315q is a matter within the discretion of the Secretary of the Army. In such a situation the function of the court is to review the Secretary's determination. The administrative decision is entitled to finality unless plaintiff can demonstrate that the Army's conduct is 'so clearly wrong as to be arbitrary.'

[2] If plaintiffs' concern is defendant's eventual return of the lands in good condition, such anxiety can be handled in the condemnation proceedings. The New Mexico district court currently has under advisement the issue of adequate compensation for the taking, and the Court of Claims, therefore, has nothing more to contribute at this stage of the proceedings.

Drucker v. *United States*, 204 Ct. Cl. 514, 518, 498 F. 2d 1350, 1352 (1974).

"On March 30, 1973, the Department of the Army denied plaintiffs' claims for additional compensation under section 315q. The Army based its denial on the ground that a portion of the 'lease and suspension' agreement payments was intended to serve as full compensation for cancellation of plaintiffs' grazing permits. Plaintiffs advance no cogent reasons which would compel us to reverse the Army's decision. From all that appears in the record, we cannot say that plaintiffs' section 315q compensation (included in the 'lease and suspension' agreements) was inadequate or that plaintiffs were in any way led to believe that they would receive additional sums for cancellation of the permits. It thus appears that the Army properly denied plaintiffs' claims for additional section 315q compensation.

In summary, plaintiffs cannot recover damages in lieu of specific performance or for a breach of the 'lease and suspension' agreements. Plaintiffs have been unable to demonstrate that they have been injured by defendant's breach of its contract to restore plaintiffs to their lands. Moreover, plaintiffs cannot recover on their Taylor Grazing Act claims because they have failed to demonstrate that the Army's decision to deny 43 U.S.C. § 315q relief was an abuse of discretion.

"Accordingly, for the reasons stated above, IT IS HEREBY ORDERED that defendant's motion for summary judgment is granted, plaintiffs' motion for oral argument is denied, and the petition is dismissed."

On December 13, 1976 plaintiffs' petition for a *writ of certiorari* was denied.

No. 330–75. JUNE 11, 1976

James H. Tanaka

Military pay; correction of military records; passovers for promotion; arbitrary and capricious action; administrative discretion.—On June 11, 1976 the court entered the following order:

Carl J. Felth, attorney of record for plaintiff. *Kinji Kanazawa*, of counsel.

Stephen G. Anderson, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges*.

"In this military pay case, before us on defendant's motion for summary judgment, the controlling issue is whether the Board for Correction of Military Records (BCMR) was arbitrary and capricious in not correcting the record of the plaintiff. He was an Air Force Captain who was twice passed over for promotion by Selection Boards and was thereafter removed from active service under 10 U.S.C. Sec. 8303. Plaintiff says that three OER's should have been removed from his file as they were erroneous and unfair, whereupon the pass-overs should have been voided. He submitted two mitigating letters asserting that in retrospect the writers, who had been rating officers, had rated plaintiff too low. They did not, however, point out any misstatements of fact in their original OER's only opinions they no longer entertained. The OER's were not harshly critical, but just rated plaintiff lower on some factors than he needed for selection at the time the Selection Boards met. An Officer Personnel Review Board had refused to add these letters to plaintiff's file or remove the challenged OER's. The BCMR, thrice applied to, found no evidence of error or injustice in the case.

"The reasons are obvious and need not be stated, that might cause a careful finder of fact to attach more weight to an original OER than to a subsequent attempt by its writer to modify it as to matters of opinion only. It is not for us to substitute our judgment for that of the military, in evaluating this kind of evidence.

"Ratings and promotions are discretionary matters. We must not interfere with these internal affairs of the military unless there is a showing of clear error, abuse of discretion, or arbitrary and capricious action. *Boyd* v. *United States*, 207 Ct. Cl. 1, *cert. denied*, 424 U.S. 911 (1975); *Dorl* v. *United States*, 200 Ct. Cl. 626, *cert. denied*, 414 U.S. 1032 (1973). By this standard, the matters the plaintiff complains about fail to tender a triable issue of fact.

"Defendant's motion also asserts laches, but the above conclusions make it unnecessary to address that issue.

"Accordingly, on defendant's motion, and on consideration of the record and briefs of counsel, but without oral argument, it is ORDERED, that the defendant's motion for summary judgment is granted and the petition is dismissed."

Plaintiff's motion for reconsideration *en banc* and a trial on the merits was denied October 1, 1976. Plaintiff's petition for certiorari was denied April 4, 1977.

No. 342–75. JUNE 11, 1976

Allied Materials & Equipment Company, Inc.

Pleading and practice; motion to dismiss; action for breach of contract; Court of Claims jurisdiction; suit pending in another court; election of forum.—On June 11, 1976 the court entered the following order:

Charles E. Raley, attorney of record for plaintiff. *Israel and Raley*, of counsel.

Robert M. Hollis, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges*.

"This case is before us on defendant's motion to dismiss. Defendant awarded plaintiff a contract for tank engine components. Defendant had previously obtained them from Continental Motors Corp., a sole source. Plaintiff alleges it was prevented from using Government-owned tools that Continental had used. An extended dispute ensued and plaintiff got into financial difficulties. Following a breakdown of negotiations, defendant terminated for convenience. Plaintiff, allegedly because of its economic distress, accepted a termination settlement of $280,503 net, but rejected it later except as partial payment. It appealed to the Armed Service Board of Contract Appeals which set the settlement aside for

duress and awarded $457,479 net, denying plaintiff's breach claims as beyond Board jurisdiction.

"On April 9, 1974, plaintiff sued in the United States District Court naming Teledyne Industries, Inc., a Continental subsidiary, several Teledyne employees and five United States Government employees, as defendants. The complaint has counts under the Anti-Trust laws, 15 U.S.C. Secs. 1, 2; for tortious interference with performance of a contract under state common law; and under the Federal Property and Administrative Service Act, 40 U.S.C. Secs. 488, 489. These latter sections make the Anti-Trust laws applicable to property disposal actions, and set up certain liabilities and penalties for fraud in connection with Government property disposal. The United States District Courts are given jurisdiction to try suits under this law.

"The suit here was filed September 19, 1975. It is based on breach of contract, and the amount claimed for the breach largely exceeds $10,000.

"The motion to dismiss sets up the District Court suit, attaching a copy of the complaint, so it properly is by Rule 38 (b) a motion for summary judgment. It relies wholly on 28 U.S.C. Sec. 1500, saying this court shall not have jurisdiction of any claim for or in respect to which the plaintiff has a suit pending in any other court either against the United States or persons acting for the United States.

"In *Casman* v. *United States*, 135 Ct. Cl. 647 (1956), we held that under law previous to Pub. L. 92–415 amending 28 U.S.C. Sec. 1491, the involved Sec. 1500 did not bar a back pay suit by an employee of the Government here, because he had a suit for reinstatement pending in a District Court. We said at 649, quoting the Supreme Court, *Matson Nav. Co.* v. *United States*, 284 U.S. 352, 355 (1932), that the purpose of Sec. 1500

> was only to require an election between a suit in the Court of Claims and one brought in another court.

"Since we have no jurisdiction of suits under the Anti-Trust laws, suits under state common law for tortious interference with contracts, or suits under 40 U.S.C. Sec. 488 and 489, and the District Court by 28 U.S.C. Sec. 1346 (2), has no jurisdiction of breach claims over $10,000, plaintiff has no

election. In neither court could it combine all its claims. In these circumstances Sec. 1500 does not support the so-called motion to dismiss.

"Upon consideration of the briefs, and record, but without oral argument, it is accordingly ORDERED, that the defendant's motion to dismiss, or motion for summary judgment is denied."

No. 343–75. JUNE 11, 1976

Albert Fleischhaker

Civilian pay; life insurance; failure of Government to withhold payment; recovery of payments.—On June 11, 1976 the court entered the following order:

Albert Fleischhaker, pro se.

Arlene Fine, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges*.

"This case is before us on the petition and on defendant's motion for summary judgment. Plaintiff, a United States Civil Servant, retired on October 31, 1969, while covered by both 'regular' and 'optional' life insurance under the Government program. For thirteen months thereafter defendant by administrative error failed to withhold from his monthly annuity payment the premium for the 'optional' insurance, as by law it should have done, until plaintiff reached 65 years of age. 5 U.S.C. Sec. 8714a(d). On discovering the error, defendant ultimately recovered the overpayment totalling $546.01, by withholding approximately $30 a month from annuity payments over eighteen months. Plaintiff sues for the $546.01 with 'compound interest.' We have jurisdiction under 5 U.S.C. Sec. 8715.

"Contrary to plaintiff, we conclude that his 'optional' insurance remained in effect without lapse during the involved thirteen month period, in the absence of any statutory or

other provision for grace periods or lapse in case of nonpayment, and the obvious entire reliance of defendant on its own act in withholding to obtain timely premium payments.

"Under 5 U.S.C. Sec. 8346(b):

> Recovery of payments under this chapter may not be made from an individual when in the judgment of the Civil Service Commission, the individual is without fault and recovery would be against equity and good conscience.

"Assuming that judicial review of a denial of relief by the said Commission such as here occurred, may be had in an instance of abuse of discretion, we see none here. Contrary to defendant's counsel, we assume the statute is applicable to the case. The plaintiff in his opposition to the motion alleges facts showing he was without fault, *i.e.*, that he was not informed his annuity would be subject to reduction for the premiums on the 'optional' insurance. On summary judgment, we must accept his statement as true. We fail, however, to find anything in the record to suggest that, even if plaintiff was without fault, he should have been exempted by reasons of equity and good conscience from refunding a manifest overpayment. As a normal matter, equity and good conscience as much as law require people to refund overpayments they have received, whether or not with fault of their own, and the exceptions require to be shown. There is no showing of any exception here.

"Accordingly, defendant's motion for summary judgment is allowed and the petition is dismissed."

On October 6, 1976 plaintiff's motion for reconsideration was denied.

No. 38–76. JUNE 11, 1976

Frank J. Bondanza and Nancy M. Bondanza

Taxes; claim for refund; limitation on filing claim.—On June 11, 1976 the court entered the following order:

Frank J. Bondanza and *Nancy M. Bondanza*, plaintiffs, *pro se.*

James L. Malone, III, with whom was *Assistant Attorney General Scott P. Crampton. Theodore D. Peyser*, of counsel.

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges*.

"This case comes before the court on defendant's motion, filed April 9, 1976, to dismiss plaintiffs' petition for the recovery of income taxes for 1968 and 1969, having been considered, together with the response in opposition thereto, without oral argument.

"The defendant's motion to dismiss is granted as to both the claim for 1968 and the claim for 1969 on the authority of *Bondanza* v. *United States*, No. 445–74, orders of May 2, 1975, Oct. 3, 1975, Nov. 6, 1975, and Feb. 6, 1976 [207 Ct. Cl. 945], and on the ground that plaintiffs failed to file timely claims for refund. As for the year 1969, the motion is also granted on the additional ground that the present claim is barred by *res judicata* in view of the determination in No. 445–74.

"IT IS THEREFORE ORDERED that defendant's said motion to dismiss the petition be and the same is granted and plaintiffs' petition is dismissed."

No. 93–63. JUNE 16, 1976

National Factors, Inc. and The Douglas Corporation

Contracts; standing to sue; revocation of corporate charter; assignee; privity of contract; breach of contract claim; termination for convenience of Government; claim of bad faith; anticipated profits.—This case has previously been before the court with respect to a procedural matter (204 Ct. Cl. 98, 492 F. 2d 1383), and pursuant to the court's directive a lengthy trial was held. On August 13, 1975 Senior Trial Judge Mastin G. White filed a recommended decision (reported in full text at 21 CCF para. 84190). On June 16, 1976 the court sitting as a panel composed of COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and KASHIWA, *Judge*, entered an order setting forth that it agreed with the said recommended

decision, as modified, in that the court considers and concludes that the portion of the recommended decision entitled "D. The 'Damages' Issue" appearing at the bottom of page 71 and continuing through page 75 of the recommended opinion is not necessary to the trial judge's conclusion and is deemed to be *dicta*. As *dicta* this portion of the recommended opinion is not adopted by the court and therefore is not a part of this court's judgment herein. The court adopted the said decision, as modified, as the basis for its judgment in this case, concluded and ordered that plaintiffs are not entitled to recover and dismissed the petition. Plaintiffs' motion for a rehearing *en banc* was denied September 30, 1976.

No. 632-71. JUNE 18, 1976

Comprehensive Designers, Inc. and Comprehensive Designers International Limited, a Consolidated Group

Pleading and practice; cross-motion for summary judgment; when leave to file is required; notice of defense of settlement.—On June 18, 1976 the court entered the following order:

Gilbert A. Cuneo, attorney of record, for plaintiffs. *James J. Gallagher*, *Sellers, Conner & Cuneo*, *Gordon W. Gerber*, *Barton J. Winokur*, *Alfred A. Gollatz* and *Dechert Price & Rhoads*, of counsel.

Richard J. Webber, with whom was *Rex E. Lee*, *Assistant Attorney General*, for defendant.

Before DAVIS, NICHOLS and KUNZIG, *Judges*.

"This renegotiation case comes before this panel of the court on defendant's Rule 53(c) request for prompt review of an order entered by Senior Trial Judge Mastin G. White, dated March 26, 1976. See the order of May 28, 1976, denying *en banc* consideration. Certified by the Trial Judge for review under Rule 53(c)(2)(ii) as involving an issue of controlling importance, the order of March 26 allowed a motion filed by plaintiffs on February 20, 1976, and ordered

(1) that defendant's cross-motion for summary judgment be stricken, and (2) that defendant not be permitted to oppose plaintiffs' motion for summary judgment on the ground that the plaintiffs' principal claim had been compromised and settled by an alleged written offer and acceptance.

"The Trial Judge entertained the opinion that the Government's cross-motion for summary judgment should be stricken for two reasons: (1) although the case had been set for trial, the cross-motion was filed without leave contrary to Rule 101(c), and (2) such a motion was 'not appropriate,' because it raised a dispute as to a material fact, namely, whether the parties had settled their differences out of court on certain aspects of the case. The theory of the Government's cross-motion was that in pre-trial negotiations the parties had concluded a binding, written compromise and settlement on the issue of excessive profits under Section 103 of the Renegotiation Act of 1951, *as amended*, 50 U.S.C. App. § 1213(e) (1970).

"By leave under Rule 101(c) plaintiffs were permitted, and did on February 18, 1976 file a motion for summary judgment asserting first that plaintiffs' business was not done under "subcontracts" as defined by the Act, and second that their profits were not excessive as a matter of law. Under Rule 14(b)(2) the reference to the Trial Judge was suspended for purposes of plaintiffs' motion for summary judgment at the instant the latter motion was filed. Defendant then had 30 days within which to file its opposition and/or cross-motion, as it saw fit, under Rule 52(b)(1). It is true that Rule 101(c) states that leave is required for the filing of a motion for summary judgment by any party after the case has been set for trial. But to give the rules a practical construction, we do not think that the leave requirement of Rule 101(c) should apply to a cross-motion, where, as in the case at bar, plaintiffs already have obtained leave and have filed a motion for summary judgment in the first instance, and the defendant is required by Rule 52(b)(1), which says nothing about leave, to respond in 30 days. A contrary construction would require yet another piece of paper to clutter

records which already are massive enough especially in renegotiation cases. We think that once plaintiffs secured leave to file their motion for summary judgment, defendant was at liberty, without regard to Rule 101(c)'s leave requirement, to file its cross-motion. Indeed, as noted above, it was required to do so by Rule 52. We think the proper interpretation of Rule 14(b)(2) is that as soon as a dispositive motion is filed the reference to the Trial Judge is suspended for purposes of such motion and also for purposes of any response thereto, including a cross-motion for summary judgment.

"In light of the court's special order of March 17, 1976, assigning to the Senior Trial Judge for 'consideration and appropriate action' plaintiffs' 'Motion to Prohibit Defendant from Raising, in Cross-Motion for Summary Judgment, Contentions Already Disposed of by the Trial Judge,' the Senior Trial Judge did not, of course, err in considering plaintiffs' motion in this case but we think he was incorrect in suggesting that defendant's cross-motion was improper because filed without leave. That motion was properly filed in the sense that in the circumstances the defendant was not required to obtain leave in order to file it.

"On the merits of defendant's cross-motion, we think that a response by plaintiffs and oral argument are warranted and therefore we vacate the Trial Judge's order without at this stage passing on the correctness of his position that the defendant's motion has raised a genuine dispute of material fact or of his position on the coverage of Federal Rule of Evidence No. 408.

"IT IS THEREFORE ORDERED, upon consideration of defendant's request for review and the reply thereto, without oral argument, that the order entered March 26, 1976 by the Trial Judge allowing plaintiff's motion of February 20, 1976 should be, and it hereby is vacated and set aside. The Clerk and the Secretary to the Court will see that the cross-motions heretofore filed by the parties are calendared for oral argument or submission in due course. We make here no conclusions as to whether the issues raised by the defendant's cross-motion can be decided upon the motions. It may be that when

plaintiffs respond to the cross-motion they will be able by affidavit to raise a genuine triable fact issue as to the alleged written offer and acceptance. This is a question, along with the applicability of Federal Rule of Evidence No. 408, which must be reserved for consideration when the motions have matured for decision.

"IT IS FURTHER ORDERED that defendant need not amend its answer to the petition in order to raise the defense of settlement, as sufficient notice thereof is now provided by its cross-motion and the proceedings heretofore had concerning the defense."

No. 46-74. JUNE 25, 1976

Ernest W. Stout

Unjust conviction and imprisonment claim for damages.—On June 25, 1976 the court entered the following order:

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge* and SKELTON, *Judge*.

"This case comes before the court on a rule to show cause why plaintiff's petition should not be dismissed, because it is apparent that it will be impossible for him to obtain the certificate required by 28 U.S.C. § 2513. Plaintiff, who was convicted of an offense, and is serving a prison term, brought this suit to recover on two counts. Count II of his petition sounds wholly in tort, and it was dismissed by order of August 15, 1975. In Count I, plaintiff sought to recover damages for unjust conviction and imprisonment as provided in 28 U.S.C. § 2513. Proceedings were suspended for 90 days in order to enable plaintiff to endeavor to acquire from the District Court For the District of Kansas a certificate containing the recitals required by that statute. Harvey Sherzer, Esquire, plaintiff's former attorney of record, made a diligent effort to obtain the necessary certificate but was unable to do so. In view of the fact that the certificate is an absolute prerequisite for plaintiff to recover, it necessarily follows that his petition must be dismissed.

"IT IS THEREFORE ORDERED that the rule to show cause is made absolute, and the petition is hereby dismissed."

Nos. 139–74 through 142–74. JUNE 25, 1976

Endowment Care Trust Fund of Inglewood Park Cemetery Association Board of Trustees

Taxes; income tax; exempt organizations; cemetery association.—On June 25, 1976 the court entered the following order:

Scott McCormac, attorney of record for plaintiff.

Patricia B. Tucker, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Robert S. Watkins*, of counsel.

Before COWEN, *Chief Judge*, SKELTON and KASHIWA, *Judges*.

"The plaintiff, Endowment Care Trust Fund of Inglewood Park Cemetery Association Board of Trustees, has filed four separate suits, which have been consolidated, for the refund of federal income taxes totaling $386,803.15 for the calendar years 1961, 1962, 1964, and 1965. The main issue concerns whether the plaintiff Trust Fund is exempt from taxation under the Internal Revenue Code of 1954. The case is before us on defendant's motion for summary judgment.

"Taxpayer is the Board of Trustees of the Endowment Care Trust Fund of the Inglewood Park Cemetery Association (the Trust Fund). The Trust Fund was created in 1953 to provide for the care, maintenance, and embellishment of the Inglewood Park Cemetery in accordance with the provisions of the Health and Safety Code of the State of California.

"The Inglewood Park Cemetery, located in Inglewood, California, consists of 285 acres of land, of which 235 acres have been subdivided and either sold as gravesites or made available for sale. The cemetery is owned and operated by the Inglewood Park Cemetery Association (the Cemetery Association), a California corporation operated for profit.

"As part of its operations, the Cemetery Association sold burial lots and crypts, operated a crematory, provided interment services, sold niches (small enclosures for the per-

manent storage of cremated remains), and provided for, supervised, and performed the general care, services, and maintenance of the cemetery. During the Association's fiscal years ending during the periods in issue, approximately $600,000 per year was expended for these purposes.

"Under the terms of the trust, the fund was administered by a Board of Trustees appointed by the Board of Directors of the Cemetery Association. The trustees could be removed at any time for any reason by the Board of Directors of the Cemetery Association. During the periods in issue, either one or all three members of the Board of Trustees were also members of the Board of Directors of the Cemetery Association. The Trust Fund had no employees other than the trustees. All clerical and bookkeeping work was performed by full-time employees of the Cemetery Association. The primary source of monies received by the Trust Fund was a portion of all proceeds from the sale of cemetery lots, niches, and crypts by the Cemetery Association.

"Under a 1957 contract between the Cemetery Association and the Trust Fund, 99 percent of the net income of the Trust Fund was turned over to the Association each month for the care of the cemetery. The funds transferred were commingled with other funds of the Association. During the years in issue, from $158,572 to $351,456 annually was turned over to the Association by the Trust Fund for maintenance.

"The principal issue in this case is whether the Trust Fund is exempt from the federal income tax as a charitable organization (Section 501(c)(3) of the I.R.C. of 1954), a social welfare organization (Section 501(c)(4)), or a nonprofit cemetery company (Section 501(c)(13)). From the foregoing facts, it is plain that the Trust Fund is merely an adjunct of the cemetery Association, and as such, must share its nonexempt status.

"This court has recognized that where one organization provides a service which is necessary to the operation of a second organization, the first will take on the tax status of the second. In the recent case of *Trustees of Graceland Cemetery* v. *United States*, 206 Ct. Cl. 609, 515 F. 2d 763 (1975), exempt status was denied to a cemetery perpetual care fund because the cemetery which received the money from the

perpetual care fund was operated for profit. That case is directly in point and is controlling here. As we stated in the *Graceland* case:

> * * * [P]laintiff's primary function was providing funds for the Cemetery Company's activities in maintaining the cemetery, which the Company would have paid for out of its own revenue in any case; thus the plaintiff must be considered an adjunct organization * * *. [*Id.* at 625, 515 F. 2d at 772.]

There are no factual differences between *Graceland* and the present case which would assist the taxpayer. Accordingly, the rule applied in the *Graceland* case—that a cemetery care fund operated in connection with a for-profit cemetery cannot be exempt from the federal income tax—requires that the claim for exemption be denied.

"IT IS THEREFORE ORDERED that the defendant's motion for summary judgment is granted and the plaintiff's petitions are dismissed."

Plaintiff's motion to set aside the order and for a new trial was denied October 6, 1976.

No. 352–74. JUNE 25, 1976

Air-A-Plane Corporation

Contracts; disputes; defective specifications; impossibility of performance; assumption of risk.—Plaintiff seeks review, under Wunderlich Act standards, of a decision by the Armed Services Board of Contract Appeals (reported at 74–1 BCA para. 10469) which denied, in large part, claims for additional compensation for work plaintiff performed which allegedly was outside the scope of its contract and/or was the result of defective specifications, and for costs it incurred in attempting to perform the contract for modification and repair of mobile air conditioning units which plaintiff considered impossible to perform under the applicable contract specifications. The Board concluded that plaintiff had assumed the risks attendant to said claimed costs, and that plaintiff had failed to carry its burden of establishing that the contract was impossible of performance. On November 12, 1975 Trial Judge Thomas J. Lydon filed a recommended

decision (reported in full at 22 CCF para. 80,405) concluding that the Board's decision is supported by substantial evidence and is otherwise correct as a matter of law. By order entered June 25, 1976 a panel composed of DAVIS, *Judge*, Presiding, LARAMORE, *Senior Judge*, and BENNETT, *Judge*, in agreeing with the recommended decision, affirmed and adopted the said decision as the basis for its judgment in this case, concluded that plaintiff is not entitled to recover, denied plaintiff's motion for summary judgment, granted defendant's cross-motion, and dismissed the petition.

No.228-75. JUNE 25, 1976

Edward Harris

Taxes; Court of Claims jurisdiction; review of Tax Court decisions; collateral estoppel.—On June 25, 1976 the court entered the following order:

Edward Harris, Pro se.

Patricia B. Tucker, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

Before COWEN, *Chief Judge*, SKELTON and KASHIWA, *Judges*.

"This case comes to us on defendant's motion for partial summary judgment with respect to plaintiff's claim for refund of tax for 1961 and his claim for general and punitive damages. Plaintiff's 1964, 1965, and 1966 federal income tax liabilities were litigated in proceedings before the United States Tax Court and were decided by memorandum opinion on November 25, 1970. The Tax Court ruled that plaintiff sustained a loss in 1964. As a result, the amount of the net operating loss carry-back to 1961 was computed. Plaintiff received a refund of $657.05 in tax and $338.92 in interest for 1961. The Ninth Circuit affirmed the Tax Court and certiorari was denied.

"Plaintiff claims a higher loss in 1964 resulting in a greater refund for 1961. Plaintiff claims that the decision of the Tax Court is incorrect and that the computations for entry of judgment were fraudulent. This court does not have jurisdiction to review the Tax Court decision. Internal Revenue Code of 1954, § 7482(a). That decision went up for review through the appropriate lines of review. Plaintiff has raised no issue as to 1964 not presented and decided in the prior case. He is collaterally estopped from relitigating the amount of his 1964 net operating loss. *Commissioner* v. *Sunnen*, 333 U.S. 591 (1948).

"The claims for general and punitive damages are claims sounding in tort over which this court has no jurisdiction. *Myers* v. *United States*, 206 Ct. Cl. 863 (1975); *Vincin* v. *United States*, 199 Ct. Cl. 762, 765, 468 F. 2d 930, 932 (1972). Therefore,

"IT IS ORDERED that defendant's motion for partial summary judgment is granted."

No. 267-75. JUNE 25, 1976

The Fort Mojave Tribe of Indians

Indian claims; Court of Claims jurisdiction; equity jurisdiction; action for an accounting by the Government; limitation of actions.—On June 25, 1976 the court entered the following order:

Richard G. Kleindienst, attorney of record for plaintiff. *Welch, Morgan & Kleindienst* and *Raymond C. Simpson*, of counsel.

Alexander J. Pires, Jr., with whom was *Assistant Attorney General Peter R. Taft*, for defendant.

Before COWEN, *Chief Judge*, SKELTON and BENNETT, *Judges*.

"This case comes before the court on defendant's motion for summary judgment and plaintiff's opposition thereto. The suit is by an Indian Tribe for an accounting by the Gov-

ernment for management of the tribe's lands from the time of the completion of the Boulder Dam on the Colorado River in 1936 to date, and for an accounting with reference to $111,547.44 paid into the Treasury for the account of the tribe in 1942 for the taking of certain of their lands in connection with the building of the Parker Dam on the Colorado River, from 1940 to the present time. We hold for the Government because of the following:

"(1) A suit for an accounting is a suit in equity and we have no equity jurisdiction except in aid of a judgment of liability against the Government. *See Klamath and Modoc Tribes* v. *United States*, 174 Ct. Cl. 483, 487 (1966); *Carney* v. *United States*, 199 Ct. Cl. 160, 462 F. 2d 1142 (1972); and *United States* v. *King*, 395 U.S. 1 (1969). Accordingly, we have no jurisdiction over plaintiff's suit for an accounting.

"(2) It appears that plaintiff's suit is barred by the six-year statute of limitations in that the events complained of occurred in 1936 and 1940. *See* 28 U.S.C. § 2501. The claim of the plaintiffs that limitations will not bar an express trust such as they allege existed here is unpersuasive. The facts do not show the existence of an express trust. The statute of limitations applies to Indians the same as to anyone else. *See Capoeman* v. *United States*, 194 Ct. Cl. 664, 440 F. 2d 1002 (1971); *Caldwell* v. *United States*, 197 Ct. Cl. 1063 (1972); and *Andrade* v. *United States*, 202 Ct. Cl. 988, 485 F. 2d 660 (1973). Plaintiff's suit is barred by limitations.

"(3) The suit by plaintiff for an accounting with respect to the $111,547.44 is without merit because it was pleaded and litigated by the plaintiff and was disposed of by the Indian Claims Commission, in *The Mojave Tribe* v. *United States*, 36 Ind. Cl. Comm. 452 (1975), Docket No. 295–A, in which case a complete accounting of this fund by the General Services Administration was introduced into evidence, showing that the $111,547.44 was paid into the United States Treasury for the tribe on February 28, 1942, and bore interest at four percent per annum on current balances, and that all of the fund and interest had been paid to and for the tribe by 1958. Furthermore, the plaintiff signed a stipulation in that case agreeing to settle all claims which 'were or could be properly asserted' by a final judgment in favor of the

plaintiff in the sum of $550,000. The Commission entered such a judgment which provided:

> 3. This judgment shall finally dispose of all claims and demands which were or could be properly asserted by plaintiff against defendant in Docket No. 295–A.

"Consequently, plaintiff was furnished an accounting as to the $111,547.44 and interest thereon, agreed to a settlement, and received a judgment in its favor. The claim is barred in this court by the doctrine of res judicata.

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted, and plaintiff's petition is dismissed."

Plaintiff's motion for relief from order was denied October 6, 1976.

No. 333–75. JUNE 25, 1976

John B. Bright

Civilian pay; Court of Claims jurisdiction; equity jurisdiction; appellate jurisdiction.—On June 25, 1976 the court entered the following order:

Before SKELTON, *Judge*, Presiding; KASHIWA and BENNETT, *Judges*.

"This case comes before the court on cross-motions for summary judgment.

"The plaintiff, John B. Bright, was appointed a probation officer for the United States District Court for the Eastern District of New York on February 26, 1973, under the provisions of 18 U.S.C. § 3654. He was dismissed on August 30, 1974, by the Chief Probation Officer because of his alleged inability to write presentence reports. Plaintiff contended that the real reason for his discharge was his criticism of the probation department, which violated his right of free speech under the Constitution, and, on that basis he asked for and was granted a hearing by Chief Judge Jacob Mishler. After the hearing, certain samples of plaintiff's reports with criticisms thereof were submitted to the Chief Judge by the Chief Probation Officer, which were not furnished to the plaintiff or his attorney. The Chief Judge approved plaintiff's dismissal and discharged him, finding that the sole

reason for his discharge was his deficiency in writing presentence reports, and that his dismissal had nothing to do with plaintiff's alleged criticism of the Probation Department. The Chief Judge, in his written opinion, held that the plaintiff was not entitled to a hearing at all on the question of his discharge for inability to write adequate presentence reports since he was not in the competitive service, 5 U.S.C. § 7501; 5 C.F.R. § 752.103; 5 U.S.C. §§ 2102(a)(2), 2103; and 5 C.F.R. § 6.4 and 213.3172, and that the only reason he was given a hearing was because plaintiff claimed his right of free speech (criticism of the Probation Department) was the cause of his dismissal.

"The plaintiff sues here, claiming his discharge was illegal because of the ex parte submission of documents to the Chief Judge as stated above. He asks this court to reinstate him to his job, for back pay to August 30, 1974, and for costs, interest and attorney fees. We hold that plaintiff has not alleged a claim on which relief can be granted by this court.

"The Court of Claims has no appellate jurisdiction nor supervisory authority over a decision of a Federal District Judge in the State of New York. This jurisdiction and authority is vested in the United States Circuit Court of Appeals for the Second Circuit.

"This court can only enter judgments for money presently due by the United States. We have no equity powers except in aid of a money judgment. *United States* v. *King*, 395 U.S. 1 (1969). The Tucker Act, 28 U.S.C. 1491, is merely a jurisdictional act and does not create any substantive right against the United States for money damages. Before we are authorized to enter a judgment against the United States for money presently due, the claimant must show a substantive right to such money damages within the guidelines of *United States* v. *Testan*, 424 U.S. 392, by reason of a contract, money improperly exacted or retained, or a provision of the Constitution, a statute or a regulation that can fairly be interpreted as mandating compensation by the Federal Government for the damage sustained. Plaintiff has not met this requirement in this case. He has not pointed to a single provision of the Constitution, a statute, or regulation that

mandates the payment of money to him because of his discharge.

"The plaintiff refers to 18 U.S.C. § 3654, but that statute is contrary to plaintiff's position, because it affirmatively provides that the district court may in its discretion remove a probation officer. It says nothing about back pay. The plaintiff also cites 18 U.S.C. § 3656, but that statute is of no help to him, as it merely directs the Director of the Administrative Office of the United States to fix the salaries and expenses of probation officers, but there is no provision for back pay.

"The regulations in the United States Probation System Administrative Manual cited by plaintiff do not mandate the payment of any back pay. Section 8.12(a)(4) provides that the service of a permanent probation appointee may be removed 'at the pleasure of the court.' Section 8.21 provides that a probation officer may be removed by the court in his discretion. Section 8.30(D) dealing with efficiency ratings and their review merely provides that a probation officer may have a hearing before the district judge if he is dissatisfied with his efficiency rating and the decision of the judge is final 'without further review.' Actually, that section is not applicable as this is not a rating case.

"None of the statutes or regulations relied on by the plaintiff mandate the payment of presently due money damages to him. He is not covered by the laws and regulations of the Civil Service, as pointed out by Chief Judge Mishler (noted above).

"We find no authority that requires or permits us to enter a money judgment in favor of the plaintiff against the United States. We have no authority to reinstate him in his job in the absence of a money judgment, as we do not have general equity powers such as those granted to Circuit Courts of Appeal, nor do we have the supervisory powers over district judges that those courts possess. *United States* v. *King*, *supra;* and *United States* v. *Testan*, *supra.* Consequently, plaintiff's claims must be denied.

"Defendant's motion for summary judgment is granted, plaintiff's cross-motion for summary judgment is denied, and plaintiff's petition is dismissed."

No. 347–75. JUNE 25, 1976

Preston M. Bannister, Jr.

Military pay; correction of military records; retroactivity of correction; limitation of actions; computation of years of service.—On June 25, 1976 the court entered the following order:

Preston Monroe Bannister, Jr., plaintiff *pro se.*

Stephen G. Anderson, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, SKELTON and KASHIWA, *Judges.*

"This case comes before the court on the parties' respective motions for summary judgment. The material facts are not in dispute.

"Plaintiff, Preston Monroe Bannister, Jr., is a former Lieutenant Commander in the United States Coast Guard. On February 3, 1967, on the basis of the recommendations of a Physical Evaluation Board (PEB I), plaintiff was placed on the Temporary Disability Retired List (TDRL) and given a 40-percent temporary disability rating.

"On December 22, 1971 and January 17, 1972, a second Physical Evaluation Board (PEB II) was convened to determined whether plaintiff was permanently disabled and, if so, to what extent. PEB II recommended that plaintiff be assigned a 40-percent permanent disability rating. Plaintiff was then placed on the Permanent Disability Retired List and retired, effective February 3, 1972.

"On March 22, 1972, plaintiff filed an application for the correction of his military record with the Coast Guard Board for Correction of Military Records (BCMR). In his application, plaintiff requested (1) 'that the percent of disability assigned by the Commandant, USCG * * * be increased to more accurately match the degrees of my permanent disabilities, and that my retired pay be increased accordingly retroactive to the date of my retirement'; and (2) that, "in the interest of justice,' he be given credit for 20 years of military

service. Plaintiff did not contend that the Coast Guard made any errors in placing him on the TDRL or in later permanently retiring him. The only error specified in his application for the correction of his record related to the disability rating assigned him.

"The BCMR acted favorably on plaintiff's request for a higher disability rating (assigning him a new rating of 70 percent). Plaintiff's record was then corrected retroactive to February 3, 1972 (the date of his permanent retirement) and his retirement pay adjusted accordingly. Plaintiff received a lump sum adjustment in retirement pay of $13,480 (covering the period from February 3, 1972, to the date of the BCMR decision). Since the latter date, plaintiff's retirement pay has been computed at the 70-percent rating assigned by the BCMR. Plaintiff's request that his record be amended to show that he had completed 20 years of service was denied.

"On March 4, 1975, in a letter to Secretary of Transportation Coleman, plaintiff requested that the correction of his record be made retroactive to February 3, 1967 (the date he was placed on the TDRL). This request was treated as a request for a further hearing and returned to the BCMR for its consideration.

"On March 24, 1975, the BCMR issued a decision denying plaintiff's request for the following reasons: (1) plaintiff's original application did not request that the record correction be made retroactive to the date plaintiff was placed on the TDRL; (2) the BCMR only considered the propriety of the rating assigned by PEB II, and (3) any attack on the PEB I decision was untimely, since more than 3 years had elapsed from the effective date of that decision.

"In his petition, filed September 25, 1975, plaintiff claims that his record should have been corrected retroactive to February 3, 1967; that he is entitled to increased disability payments for the 5-year period he was on the TDRL, and that he should have been given credit for 20 years of military service.

"After considering the motions and the parties' briefs in support thereof, the court concludes that plaintiff's claim for increased compensation for the period he was on the TDRL is barred by the statute of limitations, and that there

is no legal basis for crediting plaintiff with 20 years of military service.

"Plaintiff was paid 50 percent of his base pay for the 5 years he was on the TDRL. Although plaintiff's temporary disability rating was only 40 percent, TDRL pay cannot be less than 50 percent of one's base pay. 10 U.S.C. § 1401. He now seeks an additional 20 percent of his base pay for those same years on the ground that the BCMR decision, assigning him a 70-percent disability rating, should have been made effective retroactively to February 3, 1967 (the date he was placed on the TDRL).

"Plaintiff's cause of action arising out of the decision of PEB I accrued no later than February 3, 1967 (when plaintiff was placed on the TDRL and began receiving disability compensation at the rate set by PEB I). That was a final decision and his petition was not filed until September 25, 1975 (more than 8 years later). Thus, in the absence of a showing that plaintiff has a new cause of action based on some later event, his claim is clearly barred by the 6-year statute of limitations.

"In an attempt to surmount this problem, plaintiff contends that his claim is a 'new and continuing one,' accruing on March 24, 1975 (the date of the BCMR decision denying plaintiff's request that the correction of his record be made retroactive to February 3, 1967). The court has long recognized that a new cause of action or a 'continuing' claim can arise if a Correction Board grants the correction of records requested but stops short of giving the full relief it was compelled in law to grant *on the presentation then made. Homcy* v. *United States*, *ante* at 338, 536 F. 2d 360, 364, *cert. denied* Nov. 29, 1976; *Denton* v. *United States*, 204 Ct. Cl. 188, 195 (1974), *cert. denied* 421 U.S. 963 (1975); *DeBow* v. *United States*, 193 Ct. Cl. 499, 503, 434 F. 2d 1333, 1335 (1970), *cert. denied*, 404 U.S. 876 (1971).

"Plaintiff contends that the BCMR stopped short of giving him full relief when it refused to make his record correction retroactive to February 3, 1967. However, as the BCMR recognized in its decision of March 24, 1975, plaintiff did not request in his application that any relief granted

be made retroactive to 1967. Plaintiff merely asked that the following correction be made:

> that the percent of disability assigned by the Commandant, USCG letter of 23 February 1972 be increased to more accurately match the degrees of my *permanent* disabilities, and that my retired pay be increased accordingly retroactive to the date of my retirement. I was reduced in retired pay 108.00 dollars permonth [sic] *with this recent PDRL* [*Permanent Disability Retired List*] *action which I am herein contesting.* [Emphasis added.]

Moreover, in specifying the error he thought existed in his record, plaintiff stated that:

> [T]he percentage of disability assigned to my *permanent* disabilities is contrary to the evidence contained in the record of the *Physical Evaluation Board held in my case on 22 December 1971 and 17 January 1972.* [Emphasis added.]

"There is absolutely no indication in his application that plaintiff wanted the BCMR to consider the propriety of the rating assigned by the initial PEB in 1966. As the BCMR observed in its decision of March 24, 1975:

> [Plaintiff's] only request for retroactive correction was his simple statement that his pay be increased "retroactive to the date of my retirement." The reference to retirement, when read in the context of his application would naturally be read to mean permanent retirement, rather than the date he was placed on the TDRL, any other reading being inconsistent with the totality of his application.

Since the BCMR gave plaintiff the full relief to which he was entitled *on the presentation then made*, there was no illegal slicing of relief and no new cause of action or "continuing" claim accrued to plaintiff. *See Homcy* v. *United States*, *supra*, at 332.

"Nor can it be said that the BCMR was required to change plaintiff's temporary disability rating on its own initiative, once it changed his permanent disability rating. Plaintiff's temporary disability rating was based on facts presented to PEB I in August 1966. Plaintiff, himself, states in his petition that his physical condition rapidly deteriorated after

August 1966. *See Plaintiff's Petition*, para. 21, 23. There is no basis in the record for assuming that the facts upon which PEB II based it decision in January 1972 were identical to those facts considered by PEB I in 1966. Thus, if plaintiff wanted to obtain increased compensation for the time he was on the TDRL, he was required to specifically challenge the decision of PEB I. Since plaintiff failed to do so in a timely manner, his claim is barred by the statute of limitations.

"Plaintiff's claim that he should be given credit for 20 years of military service is also without merit. Creditable service for retirement purposes is determined under Section 1332 of Title 10 of the United States Code. Plaintiff does not allege that his length of service was incorrectly computed under this section. Plaintiff merely contends that under 10 U.S.C. § 1405 and 14 U.S.C. § 423, 6 months or more of service is counted as a whole year of service. Plaintiff was retired with 19 years, 10 months, and 2 days of service. Under plaintiff's theory, the 10 months and 2 days of service would be rounded off to 1 year's service, and he would then have 20 years of creditable service. The above sections, however, relate only to the manner in which *pay* is computed, *once an individual has qualified for retirement under other sections of the Code.* The Senate Report accompanying the enactment of 10 U.S.C. § 1405 indicates that the section is intended to be used "in computing retired pay, *but not eligibility for retirement.*" 1958 U.S. CODE CONG. & ADMIN. NEWS, at 2489 [Emphasis added.]

"No statute or regulation required the Coast Guard to keep plaintiff on active duty beyond February 3, 1967. Plaintiff does not deny that he was medically unfit for duty. Plaintiff has produced no evidence that the Commandant of the Coast Guard acted illegally or abused his discretionary authority in placing plaintiff on the TDRL. Under these circumstances, plaintiff's claim that he is entitled to credit for 20 years of service is denied.

"IT IS THEREFORE ORDERED that plaintiff's motion for summary judgment is denied; defendant's cross-motion for summary judgment is granted, and plaintiff's petition is hereby dismissed."

Plaintiff's motion for reconsideration was denied October 6, 1976.

No. 367–75. JUNE 25, 1976

Elinor Polansky

Civilian pay; dismissal; absent without leave; administrative discretion; penalty.—On June 25, 1976 the court entered the following order:

Paul C. Kurland, attorney of record for plaintiff. *Emil, Kobrin, Klein & Garbus*, of counsel.

Richard J. Webber, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and SKELTON, *Judge*.

"Plaintiff, Elinor Polansky, is a social worker who was employed in that capacity as a GS–11 by the Manhattan Veterans' Administration (VA) Hospital in New York City until January 8, 1971. On that date, plaintiff was removed by adverse action for repeated instances of absence without leave. She now brings suit for reinstatement and back pay to the date of her dismissal, and the case is before the court on cross motions for summary judgment.

"The facts surrounding plaintiff's dismissal from her job are as follows:

"In August of 1970, plaintiff met with Mr. Robert Addison, her supervisor, concerning her request to attend graduate school at Columbia University. Plaintiff desired to obtain a doctorate in social work, and wanted to go to school full-time, with the VA paying her tuition. This would permit her to work only part-time. Mr. Addison refused her request to work on a part-time basis, because the hospital had a policy against employing part-time social workers. Notwithstanding this refusal, plaintiff informed Mr. Addison by memorandum dated September 21, 1970, that she would begin classes at Columbia that day, that she would work only 20 hours per week, and that she desired an 'employee hearing to more fully

discuss the issues involved.' Mr. Addison responded with a memorandum of the same date, acknowledging plaintiff's right to a grievance hearing, but denying her request for a change of hours, and he specifically directed the plaintiff: 'You are not to deviate from the regular tour of duty (8 AM to 4:30 PM) without specific authorization to do so.'

"Plaintiff proceeded to be absent from her job without authorization and in violation of Mr. Addison's order. She submitted applications for leave to Mr. Addison and each was disapproved. On October 5, 1970, plaintiff was notified in writing of her proposed removal. The charges upon which the removal was based were the specific instances of plaintiff's absence without leave. (The charges were, in sum, that plaintiff had been absent without permission for 51 hours from September 21, 1970, to October 5, 1970.)

"On November 24, 1970, a hearing was held before a hearing officer on both plaintiff's grievance and her proposed dismissal. On December 22, 1970, the hearing officer rendered his decision. His findings of fact were as follows:

> I. Management was justified in denying Miss Polansky's request for adjustments in her attendance in order to allow her to continue her education:
>
> a. The policy of the Social Work Service at the VA Hospital precludes employment of part time Social Workers.
>
> b. In the interest of service to patients and their families Miss Polansky's supervisors could not guarantee regularly scheduled annual leave or compensatory time off.
>
> c. Again, in the interest of the needs of patients and their families Miss Polansky's supervisors could not grant her permission to take time from her regular work schedule to pursue educational courses, allowing her to work nights or weekends to complete her work week. This would be impractical in terms of supervision, interdisciplinary communications and administrative support.
>
> II. That Miss Polansky has been absent without leave from her duties at the VA Hospital, New York, N.Y., is uncontroverted. * * *

"By letter of December 23, 1970, plaintiff was notified of the final decision that she be removed. Her removal was effective January 8, 1971.

"Plaintiff then appealed to the Administrator of the VA who found that her removal was warranted. She then appealed to the Director, New York Region, U.S. Civil Service Commission. In a decision dated June 21, 1971, following an extensive analysis of the facts and law, he too denied plaintiff's appeal. Subsequent appeal to the Board of Appeals and Review was similarly unsuccessful.

"Suit was initially brought in the U.S. District Court of the Southern District of New York, but was transferred to this court in accordance with 28 U.S.C. § 1406(c) on September 24, 1975.

"Throughout her administrative appeals, plaintiff has never contended that her removal was procedurally defective, nor has plaintiff denied that she unilaterally set her own work schedule in defiance of explicit orders from her supervisor. A federal employee whose request for leave has been refused may be dismissed from his job if he takes such leave on his own initiative. *Birnholz* v. *United States*, 199 Ct. Cl. 532 (1972); *Chiaverini* v. *United States*, 157 Ct. Cl. 371 (1962); *Rubin* v. *United States*, 150 Ct. Cl. 28 (1960); *Chiriaco* v. *United States*, 235 F. Supp. 850 (N.D. Ala. 1963), *aff'd*, 339 F. 2d 588 (5th Cir. 1964). It therefore follows that plaintiff was justifiably dismissed for being absent without authorization, unless the plaintiff can show that (1) the refusal of the hospital to permit plaintiff to assume part-time status was in violation of 5 U.S.C. §§ 4101, 4103 and Executive Order No. 11348; (2) that said refusal was the result of bad faith on the part of plaintiff's superiors; or (3) that the action taken—removal—was unduly severe. Each of these issues will be treated in turn.

"Plaintiff contends that the hospital was legally obligated to grant her request that she be placed on part-time status so as to pursue her doctoral degree. Her reliance upon 5 U.S.C. §§ 4101, 4103 and Executive Order No. 11348 to support that contention is, however, misplaced. Those provisions require an agency to establish programs for the training of employees. They do not require that every employee be allowed to follow precisely the program that he or she unilaterally decides is best for the agency and himself. To allow every employee to follow such a unilateral program would

indeed create chaos in the civil service. The provisions referred to do not remove the discretion of the agency to fashion the programs which it feels are most beneficial and which will be compatible with the day-to-day functions of that agency.

"The hospital with which plaintiff was associated did in fact maintain an extensive program of employee training. Approximately twenty employees were granted educational leave for various periods of time during the period November 1969, to November 1970. Plaintiff herself was permitted to take a two-hour course at Columbia University in the Fall of 1969.

"In sum, plaintiff incorrectly assumes that the statutory provisions upon which she relies give her the right to determine when she will work and when she will not. Were employees free to make this determination, administration of the hospital would be impossible. Obviously, individual decisions with respect to educational leave must be left to the proper officials. The statutory provisions do not state otherwise.

"The hospital's refusal to permit plaintiff to assume part-time status while attending classes was made in good faith. Good faith of those taking administrative action is presumed. *Wathen* v. *United States*, 208 Ct. Cl. 342, 351, 527 F. 2d 1191, 1197 (1975); *Drucker* v. *United States*, 204 Ct. Cl. 514, 518, 498 F. 2d 1350 (1974); *Knotts* v. *United States*, 128 Ct. Cl. 489, 492, 121 F. Supp. 630, 631 (1954). Plaintiff failed at the administrative level to make a showing that the refusal to her request for leave was based on bad faith; the record is affirmatively to the contrary.

"Plaintiff's request was denied because of a hospital policy against employing part-time workers. The wisdom of the policy is, ironically, demonstrated by the adverse effects which plaintiff's own absences had upon the hospital's functions. Furthermore, plaintiff was not being discriminated against in comparison to other social workers. Her request was unique.

"Plaintiff's request was thus denied because her superiors felt that it was in the best interest of the hospital that she not

be permitted to work part-time. The presumption of good faith is fully sustained by the record.

"Removal of plaintiff for her unexcused absences was not an unduly harsh remedy. Obviously plaintiff intended to pursue her doctorate no matter what her employer said. The absences were the basis of plaintiff's dismissal, and they, by themselves, were sufficient to justify her removal. As the court said in *Chiriaco:*

> The decision of the Civil Service Commission affirming TVA's termination of the plaintiff was not arbitrary nor capricious, but was based upon substantial grounds. The actions of the plaintiff in leaving his job without permission on October 5, 1959, and continuing this unauthorized absence through October 16, 1959, was a sufficient reason, *standing alone*, for discharging him. [Emphasis supplied.] [235 F. Supp. at 853.]

"Plaintiff's affidavit, wherein she alleges that she was dismissed because of her outspokenness and desire to improve conditions at the hospital, cannot be considered by this court, as the affidavit was not part of the record during plaintiff's administrative appeals.

"IT IS THEREFORE ORDERED that the defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed."

No. 405–75. JUNE 25, 1976

Randolph D. Earnhardt

Civilian pay; dismissal; laches.—On June 25, 1976 the court entered the following order:

Randolph D. Earnhardt, plaintiff *pro se.*

Carol Hansen, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, SKELTON and KASHIWA, *Judges.*

"This case comes before the court on the parties' cross-motions for summary judgment. The plaintiff was removed for cause on April 24 1970, from his position as a Personnel Staffing Specialist at Warner Robins Air Force Base, Georgia. The removal was affirmed by the Civil Service Commission on June 11, 1970, and that determination was in turn affirmed by the Board of Appeals and Review on September 30, 1970. On December 21, 1970, plaintiff filed an action in the District Court for the District of Columbia challenging his removal and seeking declaratory and injunctive relief in addition to back pay. By order of October 31, 1972, his suit was dismissed for want of prosecution. Plaintiff's motion to reinstate his complaint was denied on November 22, 1972. Almost 3 years later, on November 18, 1975, plaintiff filed his petition in this court to recover back pay and restoration to his former position.

"Among other defenses asserted, defendant contends that plaintiff's claim is barred by the doctrine of laches and, upon review of the record, we have concluded that this contention is correct and that plaintiff's petition should be dismissed. Although plaintiff has undertaken to justify the dismissal of his action in the District Court and the lengthy delay in filing this suit, we find that the evidence on a whole is insufficient to justify the delay in the assertion of his claim. Plaintiff's claim accrued more than 5 years prior to the filing of his action in this court and, in many similar cases, we have held that prejudice to the Government manifestly results from such an unreasonable delay in the assertion of a claimant's right. *See Brundage* v. *United States*, 205 Ct. Cl. 502, 509, 504 F. 2d 1382, 1386 (1974), *cert. denied*, 421 U.S. 998 (1975); *Grisham* v. *United States*, 183 Ct. Cl. 657, 663, 392 F. 2d 980, 983, *cert. denied*, 393 U.S. 843 (1968).

"IT IS THEREFORE ORDERED that plaintiff's petition be and the same is hereby dismissed."

No. 439–74. JUNE 25, 1976

Luther G. Power, Jr.

Civilian pay; reinstatment.—On June 25, 1976 the following order was entered:

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and KUNZIG, *Judge*.

"This case comes before the court on defendant's suggestion and motion, filed May 5, 1976, for rehearing *en banc* pursuant to Rules 7(d) and 151. Upon consideration thereof, together with the response in opposition thereto, without oral argument, by the seven active Judges of the court as to the suggestion for rehearing *en banc* under Rule 7(d), such suggestion is denied. In denying rehearing *en banc* the court emphasizes that it deems that plaintiff, in his opposition to the defendant's petition for rehearing *en banc* and for rehearing, has rejected the position that he had to be reinstated, and the court concludes that he is content with the relief he has been accorded. In that situation reinstatment is certainly not mandatory, just as it would not be if plaintiff had failed to ask for reinstatement in his petition [See Rule 35(g)] or other papers. If defendant remains fearful that, despite plaintiff's position on the rehearing petition, he will be able to recover back-pay indefinitely, it can always reinstate him voluntarily. The court's decision [reported at 209 Ct. Cl. 126, 531 F. 2d 505 (1976)] does not preclude such action by the Government.

"The case having been further so considered by the panel listed above as to the motion for rehearing under Rule 151,

"IT IS ORDERED that defendant's said motion for rehearing be and the same is denied."

BENNETT, *Judge*, dissenting, with whom SKELTON, *Judge*, joins:

"I respectively dissent from the action of the majority in refusing an *en banc* rehearing, limited, however, to the narrow ground of its refusal to reinstate plaintiff to his position as he requested in paragraphs I and VIII of his petition. The court has held that plaintiff is entitled to back pay because his discharge was illegal since in the court's opinion it was an excessive penalty for his offenses. In declining to reinstate plaintiff, the opinion of the court explains it only by saying 'we have determined *not* to order reinstatement in this action in the light of the unusual nature of this case.'

[Emphasis in text.] The action of the court not to reinstate is implicitly based upon the language of the remand and reinstatement statute, Pub. L. 92–415, August 29, 1972, 86 Stat. 652, 28 U.S.C. § 1491 (Supp. III, 1973), which states, in pertinent part:

> * * * To provide an entire remedy and to complete the relief afforded by the judgment, the court *may*, as an incident of and collateral to any such judgment, issue orders directing restoration to office or position, * * *. [Emphasis supplied.]

A literal reading of the statutory language suggests that it is permissive, not mandatory. But, "* * * federal courts have allowed the expressed intention of Congress * * * to prevail over the alleged plain-meaning of a statute." *International Telephone and Telegraph Corp.* v. *United States*, *ante* at 412, 536 F. 2d 1361, 1362. This statute cannot be read literally as the majority reads it because the legislative history of the provision and the Supreme Court clearly tell us that the statute 'does not extend the classes of cases over which the Court of Claims has jurisdiction,' H.R. REP. No. 92–1023, 92 Cong., 2d Sess. 3 (1972); S. REP. No. 92–1066, 92d Cong. 2d Sess. 1 (1972); 118 CONG. REC. H3769 (May 1, 1972); *United States* v. *Testan*, 424 U.S. 392 (1976). The Court of Claims has never had authority to determine who shall be appointed to government jobs under Civil Service, who shall be promoted, or who shall be fired. This is so well established as scarcely to need citation of authority. 'The power of removal from office in the executive branch of the Federal Government, absent some specific provision to the contrary, is incident to the power of appointment. *Keim* v. *United States*, 177 U.S. 290, 293 (1900).' *Morelli* v. *United States*, 177 Ct. Cl. 848, 858 (1966); *Sampson* v. *Murray*, 415 U.S. 61, 70 n. 17 (1974). Thus, notwithstanding the fact that the court cannot discharge plaintiff, since the remand statute brought about no change in the law that makes discharges discretionary solely with the executive, limited only by the proper exercise of that discretion in accordance with the procedures established therefor, the court has in fact discharged plaintiff by refusing to reinstate him.

"When a plaintiff is awarded back pay it is because he has been found not to have been legally separated from the payroll. *Crocker* v. *United States*, 130 Ct. Cl. 567, 127 F. Supp. 568 (1955). So, by what logic and upon what grounds can it be held that plaintiff will not be reinstated when the court holds that he has never been legally discharged in the first place? To so hold is to say that the court can exercise the discretion of the executive and discharge plaintiff. Here the court does not even say why it removes him. It does not have such removal authority. On the contrary, as shown above, it has never claimed heretofore to have such authority, which is denied to it. Under the Back Pay Act, 5 U.S.C. § 5596 (1970), the court can review an adverse action, such as here, and award back pay for an illegal removal from position. But, nowhere is the court given any authority to fashion its own remedy in addition thereto, except reinstatement to make plaintiff whole because of the wrong done to him. We thus have here a case of first impression on the proposition of whether or not the court can construct relief short of reinstatement under Pub. L. 92–415. The testimony in support of the remand and reinstatement act, and the committee reports thereon, make it plain that not only was the jurisdiction of the court not being increased or changed thereby but that the purpose of the legislation was to enable the court when it awards back pay to make a plaintiff whole by reinstating him to his job. Prior to 1972 the power of reinstatement resided alone in the district courts and a plaintiff who won back pay in the Court of Claims then had to go to the district court in a *pro forma* action to get reinstated. This was unwise so the Congress said that in such circumstances the Court of Claims may make him whole by reinstatement, all in one action. It did not say that his partial relief in this court should be continued as before the remand and reinstatement statute. To do so would have rendered that statute meaningless. Nor did Congress say that the court should have new authority to decide whether he should be separated when he is granted back pay because he should not have been separated. It would be strange indeed if the court's view is correct that we have authority to say plaintiff should be separated from the payroll at the same time we give him back pay because we find he

should not have been separated. This is inconsistent and contrary to the intent of the remand statute, and frustrates it. Also, it usurps executive authority in determining who should be fired, and for subjective reasons different from those which say he should not have been fired and is entitled to back pay. It is just as wrong to do this as for the court to say who should be appointed or promoted when no regulation or statute has been violated. Discretion to hire, fire, and promote is not a judicial function.

"The opinion of the court presents still another difficulty. Although the petition demands reinstatement, plaintiff's response to defendant's motion for rehearing does not emphasize it, yet does not repudiate the petition. The court seizes upon this as amounting to waiver. It is defendant here who reminds the court that it has always been held that once there is an award of back pay there exists a continuing liability to award back pay until the individual is reinstated and properly discharged. The court in *Ainsworth* v. *United States*, 185 Ct. Cl. 110, 399 F. 2d 176 (1968), quoted with approval the language of a dissent describing the result in *McGuire* v. *United States*, 145 Ct. Cl. 17, 24–25 (1959), that the plaintiff 'gets judgment now for the pay he would have earned to date, and the next year he can bring another suit for his pay for that year, and so on until he is formally reinstated and discharged according to law.' Recently the Supreme Court, in discussing cases of wrongful discharge or suspension said: '* * * at least since the Civil Service Act of 1883, the employee is entitled to the emoluments of his position until he has been legally disqualified.' *United States* v. *Testan*, *supra*, at 402. *See also*, *United States* v. *Wickersham*, 201 U.S. 390 (1906), affirming the rule announced in *Lellmann* v. *United States*, 37 Ct. Cl. 128 (1902); *United States* v. *Perkins*, 116 U.S. 483 (1886); *Simon* v. *United States*, 113 Ct. Cl. 182, 198 (1949); *Borak* v. *United States*, 110 Ct. Cl. 236, 78 F. Supp. 123, *cert. denied*, 335 U.S. 821 (1948). Under the precedents, all that could bar plaintiff from getting other judgments for his back pay, based on what the court has held to be an illegal discharge, would be to hold he waived it in his response to defendant's motion (as the order of the court does here), or if he waited too long to claim such pay and was barred by laches.

Plaintiff will otherwise be able to recover his salary from now on by bringing successive suits to recover on his continuing claim without performing any service. This is not in the public interest. It would be better to reinstate him in his position and if he is an incompetent or dishonest employee the agency can find a way to discharge him according to law. If the court does not follow this course, it is repudiating its precedents on the theory of back pay, and it is misconstruing the intent and purpose of the remand and reinstatement statute which was designed to make a wronged government employee 'whole' in his remedy. It is restricting his rights and giving him half a loaf. I agree that a plaintiff should not be reinstated unless he asks for it, as his petition does here. I do not agree that a waiver of such demand is implied here. The order of the court cites no authority to support its conclusion. On the contrary, the court has previously held that it will not without a proper showing, imply a waiver. *New York Shipbuilding Corp.* v. *United States*, 180 Ct. Cl. 446, 385 F. 2d 427 (1967). The court also holds that just because it does not reinstate him is no bar to the agency doing so if it fears another suit for back pay. If the court is not going to insist upon making plaintiff whole, his agency is unlikely to feel under any compulsion to do so. True, the court does not order that plaintiff not be reinstated, but why should the agency reinstate him when the court indicates that it holds the belief plaintiff has waived his claim to reinstatement? What the court has failed to do here is to face up to what the reinstatement and remand statute means when it awards back pay in a case where plaintiff has also asked for reinstatement. It is not entitled to anticipate a waiver in such a case in a potential proceeding subsequent to its judgment. Having sought unsuccessfully to extend the remand and reinstatement statute into areas where it had no jurisdiction in *Testan*, *supra*, the court is overreacting in not employing the statute where it clearly has authority and, I think, a compelling duty to do so. 'A court must be particularly cognizant of the implications of a given case in the situation where it is confronted with clear evidence of legislative intent and must formulate an application of the statute which further such Congressional

purpose.' *First Nat'l City Bank* v. *United States*, *ante* at 403–04, 537 F. 2d 426, 442."

No. 342–72. JULY 23, 1976

Alice R. Hopkins, Administrator of the Estate of Roy C. Hopkins

On July 23, 1976 the court entered the following order in the above-identified case:

"This case comes before the court on remand from the Supreme Court, filed July 22, 1976, wherein that court on June 24, 1976, ordered and adjudged that the judgment entered by this court, on March 19, 1975, 206 Ct. Cl. 303, 513 F. 2d 1360, in this case be, and is, affirmed in part and vacated in part and remanded the cause for further proceedings in conformity with the Supreme Court opinion in *United States* v. *Alice R. Hopkins*, 427 U.S. 123 (1976). Upon consideration thereof,

"IT IS ORDERED that the portion of the judgment of this court, entered on March 19, 1975, deciding that plaintiff held his employment position by virtue of an express or implied contract, rather than by appointment, is vacated and withdrawn and the case is returned to the trial division of this court for further proceedings on that question and in conformity with the opinion and remand of the Supreme Court."

No. 293–74. OCTOBER 28, 1976

Velma L. Crone, et al.

Military pay; Missing Persons Act of 1942; pay and allowance claim.—On October 28, 1976 the court entered the following order (as amended pursuant to order of October 29, 1976):

Dermot G. Foley, attorney of record, for plaintiffs. *Kaplin, Kilsheimer & Foley*, *R. Alan Stotsenburg*, *Michael Hausfeld*, and *Jerry S. Cohen*, of counsel.

Susan M. Linden, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, DAVIS and KUNZIG, *Judges*.

"This case comes before the court on Plaintiffs' Motion for Rehearing and Defendant's Response thereto [*See* opinion, *ante* at 499]. Upon consideration thereof, the court finds that there may be an issue of fact as to whether Velma L. Crone was the financial dependent of her son, *i.e.*, whether she was dependent upon him for more than one-half of her support. If she was, she has standing to sue along with Patricia Heideman and Susan Sullivan.

"In view of the uncertainty, the issue is remanded to the trial judge, who shall, if plaintiff Crone so requests, hear evidence and determine whether Velma L. Crone was in fact dependent upon her son for more than one-half of her support. This determination should be made in advance of any other hearing on the merits. If the trial judge determines that she was a dependent in fact, the court's opinion of July 9, 1976, insofar as it dismissed the petition of Velma L. Crone, is vacated and withdrawn, and the trial judge shall thereafter permit her to participate as a party plaintiff in the proceedings heretofore remanded to the Trial Division.

"In all other respects, plaintiffs' motion for rehearing is hereby denied."

JUDGMENT ORDERS

HOMER A. BREITBECK, ET AL. *v.* THE UNITED STATES

No. 285–73

[205 Ct. Cl. 208, 500 F. 2d 556]

On a stipulation of the parties filed May 12, 1976, judgments were entered on May 14, 1976 for those plaintiffs whose names appear on the list accompanying the judgment order in the amounts noted.

UNION PACIFIC RAIROAD COMPANY V. THE UNITED STATES

No. 481–73

On June 18, 1976 the court ordered that judgment be entered for plaintiff in the sum of $220,858.84.

UNION PACIFIC RAILROAD COMPANY V. THE UNITED STATES

No. 464–72

On June 18, 1976 the court ordered that judgment be entered for plaintiff in the sum of $49,105.85.

GEORGE E. DECKER AND EFFIE J. DECKER V. THE UNITED STATES

No. 142–75

[209 Ct. Cl. 217, 531 F. 2d 543]

On June 18, 1976, in accordance with a stipulation of the parties, the court ordered that judgment be entered for plaintiffs for $1,455.31, plus interest as provided by law.

BURLINGTON NORTHERN INC. V. THE UNITED STATES

No. 69–74

On June 25, 1976 the court ordered that judgment be entered for plaintiff in the sum of $280,660.24.

JOHN W. YEE V. THE UNITED STATES

No. 449–73

[206 Ct. Cl. 388, 512 F. 2d 1383]

On June 25, 1976 the court ordered that judgment be entered for plaintiff in the sum of $8,275.09.

BOISE CASCADE CORPORATION AND SUBSIDIARY COMPANIES

V. THE UNITED STATES

Nos. 321–69 and 81–71

[208 Ct. Cl. 619, 530 F. 2d 1367]

On July 2, 1976 the court ordered that judgment be entered for plaintiff in the sum of $481,654.73, plus interest as allowed by law. Plaintiffs' Motions for relief from judgment were denied September 30 and November 26, 1976.

GLENN BERRY MANUFACTURERS, INC. V. THE UNITED STATES

No. 604–71

On July 2, 1976, in accordance with a stipulation of the parties, the court ordered that plaintiff is indebted to defendant in the sum of $123,890 and also dismissed with prejudice plaintiff's petition and defendant's counterclaim.

C. E. HOOPER, INC. V. THE UNITED STATES

No. 68–73

[210 Ct. Cl. 615, 539 F. 2d 1276]

On July 23, 1976 the court ordered that judgment be entered for plaintiff in the sum of $39,416.58, plus statutory interest.

REPORT OF DECISIONS
OF
THE SUPREME COURT
IN COURT OF CLAIMS CASES

Action was taken by the United States Supreme Court on the parties' petitions for writs of certiorari as follows:

Petitioners	Ct. Cl.	F. 2d	Supreme Court
			Denied
Aetna Casualty & Surety Co----	208:515	526:1127	425 U.S. 973
No. 67-74			May 19, 1976
W & W Fertilizer Corp----------	208:443	527:621	425 U.S. 974
No. 17-74			May 19, 1976
Dan Bartos----------	208:966	----------	426 U.S. 910
No. 329-74			June 1, 1976
Tanker Hygrade No. 18, Inc----	208:488	526:805	426 U.S. 920
No. 439-73			June 7, 1976
Walter J. Sampson, et al--------	208:656	529:1299	426 U.S. 921
No. 379-68			June 7, 1976
			Granted
Penn Security Life Ins. Co------	207:594	524:1155	425 U.S. 990
No. 109-68			May 24, 1976
Consumer Life Ins. Co----------	207:638	524:1167	425 U.S. 990
No. 463-70			May 24, 1976

THE UNITED STATES v. ALICE R. HOPKINS, ETC.

No. 342-72

[206 Ct. Cl. 303, 513 F. 2d 1360]

Plaintiff, now deceased, a civilian employee of the Army and Air Force Exchange Service (AAFES), filed an action in the Court of Claims seeking back pay and appropriate allowances claiming that he was wrongfully discharged. He asserted jurisdiction under the Tucker Act, 28 U.S.C. § 1491, as amended, 84 Stat. 449 (1970), which provides for suits in the Court of Claims upon any express or implied contract

with such military exchanges. The United States moved to dismiss for lack of jurisdiction. The Court of Claims concluded that it had jurisdiction because the employee's relationship with AAFES was based upon an implied contract of employment and such a contract is covered since 1970 by the Tucker Act. On the Government's petition for certiorari, the Supreme Court in an opinion dated June 24, 1976, 427 U.S. 123, held that the Court of Claims erred in its threshold determination that AAFES employees could *never* serve by appointment, the Court vacated that portion of the judgment of the Court of Claims deciding that plaintiff held his employment position by virtue of an express or implied contract, rather than by appointment, and remanded the cause for further proceedings on that question.

MISSING PAGES ARE INDEX PAGES
WHICH HAVE BEEN PHOTOGRAPHED
AT THE BEGINNING OF THE VOLUME(S)